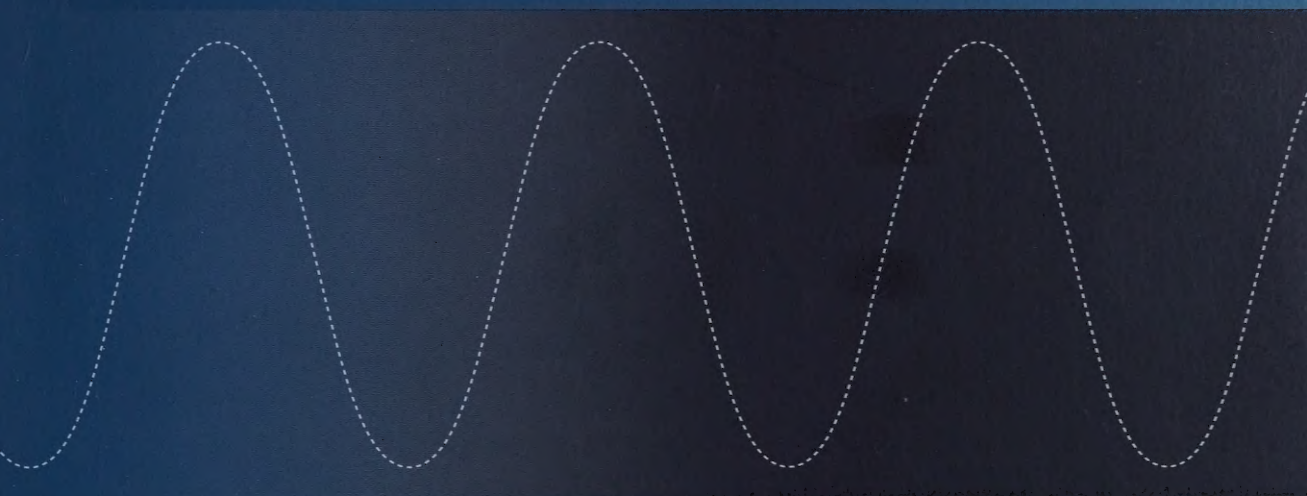


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ZARGON
OIL & GAS LTD.

ANNUAL REPORT 2002



CREATING VALUE
THROUGH A COUNTER-CYCLICAL
STRATEGY

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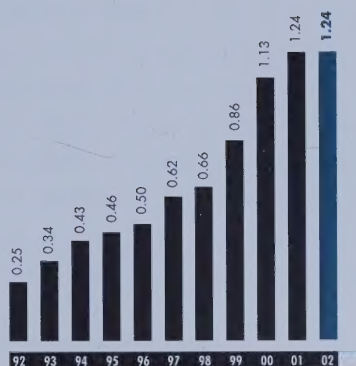
CORPORATE PROFILE

Zargon Oil & Gas Ltd. is a junior oil and natural gas exploration, development and production company operating in the Canadian provinces of Alberta, Saskatchewan and Manitoba and in North Dakota, US. Throughout its eleven year history, Zargon has adhered to a disciplined "value seeking" counter-cyclical approach which has delivered 44 consecutive quarters of positive earnings (37 quarters as a public company), a weighted average 16.3 percent annual return on equity, and a per share compounded proven reserve and production growth rate of 16 percent per year. With resource inventories of 331,000 net acres of undeveloped land and 130 million barrels of working interest oil-in-place available, Zargon is particularly well positioned this year to provide profitable growth from its existing assets. Zargon's common shares trade on the Toronto Stock Exchange under the symbol "ZAR".

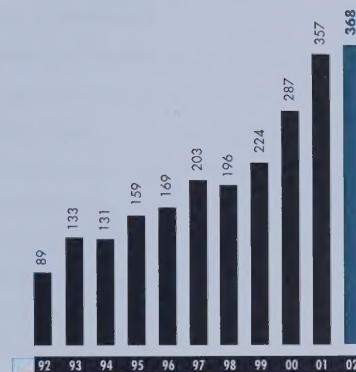
ANNUAL MEETING

The Annual General and Special Meeting of Shareholders will be held on Thursday, May 15, 2003, at 2:00 p.m., at the Metropolitan Centre, Strand/Tivoli Room, 333 - 4th Avenue SW, Calgary, AB. Shareholders are encouraged to attend.

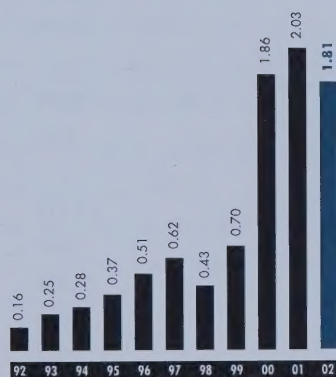
CORPORATE
HISTORY
AT-A-GLANCE



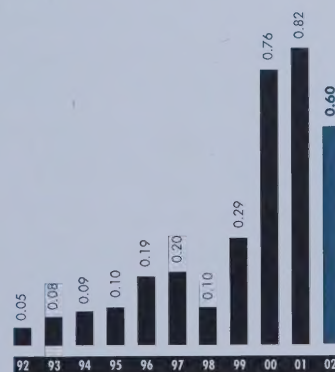
Proven Reserves Per Share
(boe/share)



Production Per Share
(boe/d per million shares)



Cash Flow Per Share
(\$/share - diluted)



Earnings Per Share
(\$/share - diluted)

CORPORATE
HIGHLIGHTS

FINANCIAL (\$ million, except per share amounts)

INCOME AND INVESTMENTS

	2002	2001	Percent Change
Production revenue	65.54	63.80	3
Cash flow from operations	32.12	32.67	(2)
Net earnings	10.68	13.14	(19)
Net capital expenditures	35.55	55.18	(36)

BALANCE SHEET AT YEAR-END

Property and equipment, net	141.01	118.99	19
Bank indebtedness	25.28	24.14	5
Shareholders' equity	86.60	69.99	24
Common shares outstanding (million)	17.64	16.67	6

PER COMMON SHARE, DILUTED

Cash flow from operations (\$/share)	1.81	2.03	(11)
Net earnings (\$/share)	0.60	0.82	(27)

OPERATING

AVERAGE DAILY PRODUCTION

Oil and liquids (bbl/d)	2,968	2,441	22
Natural gas (mmcf/d)	20.29	18.67	9
Equivalents (boe/d)	6,349	5,553	14

AVERAGE SELLING PRICE (before hedges)

Oil and liquids (\$/bbl)	34.45	31.86	8
Natural gas (\$/mcf)	3.81	5.19	(27)

PROVEN RESERVES (year-end)

Oil and liquids (mmbbl)	11,114	10,482	6
Natural gas (bcf)	64.54	60.74	6
Equivalents (mboe)	21,870	20,605	6

WELLS DRILLED, NET

	31.6	47.7	(34)
--	-------------	------	------

UNDEVELOPED LAND (thousand net acres)

	331.3	240.7	38
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PER MILLION COMMON SHARES (year average basic)

Production (boe/d)	368	357	3
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PER COMMON SHARE (year-end basic)

Proven reserves (boe)	1.24	1.24	—
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Note: Throughout this report the calculation of barrels of equivalent (boe) is based on the conversion ratio of one barrel of oil is equivalent to six thousand cubic feet of natural gas.

Zargon's 2003 capital programs will build on our 2002 success in delivering natural gas production gains through exploration initiatives on an expanded undeveloped land base in West Central Alberta.

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PRESIDENT'S MESSAGE

THE YEAR IN BRIEF

Zargon had a year of solid progress in 2002. Operating parameters were strongly positive: production of oil equivalents increased 14 percent over 2001, our undeveloped land inventory increased 38 percent and proven reserves increased six percent. The growth in undeveloped land is particularly significant as it was accomplished at price levels well below current market values and forms the base for internally generated natural gas production and reserve growth in 2003 and beyond. Revenue and cash flow during 2002, although historically large, were little changed from the previous year because of the exceptional gas pricing experienced during the first quarter of 2001. Zargon's balance sheet continued to remain very strong.

POLICIES AND STRATEGIES

For the past eleven years, Zargon has created value by following a well-defined counter-cyclical strategic plan. We have successfully exploited oil properties and explored for natural gas using a strong intellectual and professional bias that has consistently delivered efficient reserve and production growth through the reduction of risk and the containment of costs. Zargon monitors its progress by measuring four key parameters on a per share basis: proven reserves, production, cash flow and earnings. Using these parameters, our aggregate compounded growth rate is an exceptional 22 percent for our entire eleven year history. Considering only the fundamental, non-financial and non-price dependent parameters of proven reserves and production, Zargon's annual per share growth has averaged 16 percent. Over the last five years proven reserves and production have shown a 17 percent compounded rate of growth per share. We have now achieved 44 consecutive quarters of positive earnings, a record that we are resolved to sustain for the foreseeable future. Also, the dollar weighted average return on equity over the eleven year period has exceeded 16 percent per year.

To achieve this growth, Zargon manages and allocates capital with financial discipline based on careful attention to the commodity price cycle, which ultimately drives our industry's activity levels and profitability. We believe that high-price, high-activity periods for the industry such as those experienced in late 2002 and currently occurring in early 2003 are firstly a time to exploit existing lands, expand production and build financial strength, and secondly a time to sell non-core and higher cost properties. Conversely, as commodity prices declined and industry activity was reduced in the first three quarters of 2002, we were able to economically expand Zargon's inventory of natural gas exploration opportunities.

EXPLOITATION AND EXPLORATION

In every phase of our industry's business cycle, two distinct, complementary skills have facilitated Zargon's growth - the efficient exploitation of oil properties and the seismically-driven exploration for natural gas.

From our inception, we have been skilled at the efficient exploitation of oil properties. We start by identifying and acquiring underdeveloped properties, and we deploy improved recovery techniques or geologically driven exploitation concepts to develop additional reserves. The resource inputs for our oil exploitation business are the acquisition of existing properties characterized by a large inventory of oil-in-place. Over our history, through numerous property and corporate acquisitions, Zargon has assembled a working interest inventory of 130 million barrels of exploitable oil-in-place, primarily located in Southeast Saskatchewan and North Dakota.

In the last five years, we have broadened our capabilities to explore for shallow and medium depth natural gas reservoirs based on seismic, geological, and occasionally reservoir engineering concepts. Our strategy is to acquire large contiguous land blocks with multi-zone potential and reduce exploration risk by applying advanced seismic and detailed geological mapping. The resource inputs for our natural gas exploration business are seismically or geologically prospective undeveloped lands, preferably in areas where we control natural gas facilities. Until this year, our natural gas exploration and development activities have been located primarily in East Central Alberta. During 2002, we successfully built similar type natural gas opportunities in selected areas of West Central Alberta. The results from this initiative were good and by year-end both undeveloped lands and natural gas production rates in West Central Alberta had shown threefold gains. Overall, Zargon's total undeveloped land inventory grew by 38 percent in 2002 to reach over 331 thousand net acres.

FINANCING GROWTH

We have generally used cash flow and debt to fund our growth internally. Because Zargon carries only a moderate level of debt and maintains a conservative balance sheet, we have the flexibility to capture opportunities as they arise. We supplement our capital funding by selective equity issues or by periodically disposing of non-core assets, as well as mature assets with limited growth potential.

Finally, we exploit the dynamics of the commodity price cycle in order to improve our returns. We believe that over time, market supply and demand conditions force oil and natural gas prices into large mean-reverting cycles. We also have seen that over a longer term, oil and natural gas prices are strongly correlated. For this reason, we take a disciplined counter-cyclical approach to our business, whereby we allocate capital on the basis of our long-term mean price expectations. This philosophical position translates into a strategy of acquiring our paramount resource inputs of underdeveloped oil properties and undeveloped natural gas exploration lands when commodity prices are low and industry's enthusiasm is muted. During high price periods, assets are harvested through the disposition of fully developed properties, or through accelerated but disciplined development drilling programs. This approach has been a fundamental part of Zargon's success.

STANDING, LEFT TO RIGHT: DAN ROULSTON, JOHN MCCUTCHEON, YVES GAUTHIER, SHEILA WARES
SEATED, LEFT TO RIGHT: KEN YOUNG, MARK LAKE, CRAIG HANSEN

THE ZARGON
MANAGEMENT
TEAM



2002 KEY ACHIEVEMENTS

Zargon's strategic focus during 2002 was to deliver production growth with strong financial results, while positioning the Company for substantial future natural gas production and reserve growth from an expanded West Central Alberta natural gas exploration base. Zargon's 2002 initiatives were for the most part successfully achieved. Revenue and cash flow in 2002 were strong and little changed from the record levels attained in 2001. Production of oil and liquids increased by 22 percent from the previous year, production of equivalents increased by 14 percent and proven reserves increased by six percent.

Unusually wide swings in commodity prices characterized 2002, which began with relatively low prices and ended in a period of extremely high levels. As undeveloped land prices tend to follow the commodity cycle with a short lag time, the first three quarters of the year created a window of opportunity to acquire natural gas exploration lands at reasonable prices. Zargon responded aggressively to this opportunity and acquired 72.5 thousand net acres at an average cost of \$58 per acre.

The largest single capital transaction in 2002 was the June 17 acquisition of Hadrian Energy Corp., a private company, for \$9.60 million made up of \$4.75 million cash and the issuance of 542 thousand Zargon shares valued at \$8.75 per share. The transaction brought Zargon substantial natural gas exploration opportunities with additional benefits of some natural gas production and sizeable surplus tax pools.

Zargon had a very good year with the drill bit in 2002. The 31.6 net well program provided 20.7 net natural gas wells, 6.9 oil wells and 4.0 net dry holes for a success ratio of 87 percent. This success ratio was delivered despite a natural gas focused 73 percent weighting to exploration wells, during a year in which we emphasized new exploration concepts in the expanding West Central Alberta core area.

Our substantial progress with the West Central Alberta natural gas exploration initiative is becoming evident. Within a twelve month period we increased our undeveloped lands in West Central Alberta from 38.4 to 109.1 thousand net acres and natural gas production climbed from 1.62 (January 2002) to 4.90 (December 2002) million cubic feet per day. Furthermore, the three separate natural gas exploration areas of Peace River Arch, Greater Highvale and Pembina shallow have been assembled and are poised to provide further natural gas production growth through expanded drilling programs constituting more than one half of our total 2003 drilling activity.

Despite a substantially reduced 2002 East Central Alberta drilling program, our drilling results, especially in Jarrow, were very encouraging. Jarrow's natural gas production was maintained at stable rates throughout the year with the drilling of only 5.9 net wells. By methodically drilling our sizeable inventory of prospects on Zargon's 115.8 thousand net acre Jarrow undeveloped land block, we anticipate stable natural gas production from the Jarrow property for many quarters to come.

Although only comprising 35 percent of the 2002 total capital program, Zargon also made significant progress with its oil exploitation programs. In the second half of the year, Zargon implemented waterflood pressure support programs at the Haas Unit in North Dakota and at the Frys East property in Southeast Saskatchewan. The Haas property has shown excellent early waterflood response with a 38 percent production gain over the first five months to the current net rate of 690 barrels per day. Activities on numerous Southeast Saskatchewan waterflood and development projects are in process and will provide oil production gains for the foreseeable future.

Despite lower commodity prices at the start of 2002, strong market demand for producing properties propped up property acquisition prices to levels that, based on our long-term mean price expectations, often exceeded our view of acceptable returns. We were however, successful in acquiring \$7.39 million of exploitable oil properties during the year at acceptable prices. These acquisitions were relatively evenly divided between existing Southeast Saskatchewan waterflood expansion projects and a new exploitable oil pool in West Central Alberta.

Consistent with our counter-cyclical strategy, Zargon sold 17 minor properties in the fourth quarter of 2002 for an aggregate amount of \$3.13 million. These properties were either very small, or provided low operating netbacks during low price periods. Because of the cyclically high demand for property acquisitions, we were able to obtain premium sale prices for the majority of these transactions.

Our 2002 proven finding and development cost of \$9.92 per barrel of equivalent continued to exceed our target, mostly due to a negative proven natural gas reserve revision of 5.62 billion cubic feet on certain wells in Jarrow and other East Central Alberta properties. The revisions relate primarily to reserve reappraisals for 2000-01 vintage natural gas wells that had been originally evaluated with volumetric reserve assignments in the absence of production data. Excluding these prior year revisions, the proven finding and development cost for 2002 activities would have been a very acceptable \$8.19 per barrel of equivalent.

2002 OPERATING HIGHLIGHTS

Net capital expenditures in 2002 totalled \$35.55 million, with \$23.90 million allocated to exploration and development activities. Operating highlights included:

- A 22 percent increase in oil and liquid production to 2,968 barrels per day.
- A nine percent increase in natural gas production to 20.29 million cubic feet per day. Further gains in natural gas production were obtained in fourth quarter drilling enabling Zargon to exceed its year-end exit rate projection of 23.5 million cubic feet per day.
- A 158 percent replacement rate of oil production with proven oil and liquid reserve additions totaling 1.72 million barrels.

- A 151 percent replacement rate of natural gas production with proven natural gas reserve additions totaling 11.21 billion cubic feet (16.83 billion cubic feet before reserve revisions).
- A 38 percent increase in Zargon's undeveloped land inventory to 331.3 thousand net acres.
- As commodity prices improved in the second half of the year, drilling activity was increased to 24.5 net wells, taking the year's total to 31.6 net wells.

2002 FINANCIAL HIGHLIGHTS

Improving commodity prices in the second half and higher production volumes in 2002 enabled Zargon to nearly match the record high revenue and cash flow attained in 2001. Financial highlights in 2002 include:

- Cash flow from operations of \$32.12 million versus \$32.67 million in 2001. Cash flow per diluted share however fell by 11 percent to \$1.81 in 2002, reflecting the higher average number of shares outstanding in 2002.
- Earnings were \$10.68 million in 2002 compared to \$13.14 million in 2001, the biggest factor being an increase in depletion charges per barrel of equivalent of production. Earnings per share were down similarly at \$0.60 per diluted share in 2002 compared to \$0.82 in 2001.
- Zargon's after tax return on equity averaged 13.6 percent in 2002.
- Zargon's 2002 capital program of \$35.55 million was financed almost entirely from cash flow from operations plus the small tranche of equity issued to the Hadrian shareholders. The Company's year-end debt and working capital deficiency totalled \$28.74 million, which is equivalent to only 11 months of 2002 cash flow.

OUTLOOK

Zargon, like many of its peers, is entering 2003 with exceptionally strong cash flows. Crude oil prices are at high levels with a threatened Middle East war, and historically low US inventories. Natural gas is clearly and seriously under-supplied in North America and the near month and forward curve prices are correspondingly high and seem likely to remain so for a significant time period.

Natural gas exploration in Western Canada is at record levels, the price of raw land at Crown sales has again risen sharply and property transactions are few in number and are defined by very high price parameters. Zargon perceives 2003 as a year to focus on internally generated growth and we have strongly positioned the Company to do so. The land and corporate acquisitions made in 2002 have provided us with an exploration platform that is considerably stronger and broader than at any time in our history, our balance sheet is strong and our operating cash flows are at very high levels. Our exploration management skills have

been honed and our professional team has been strengthened. We are budgeting capital expenditures of \$45 million in 2003 and we look forward to an exploration program that while natural gas-focused, also has a sizeable component of oil exploitation.

In 1999 and 2000, Zargon had focused on growing its natural gas business. In 2001, we had planned on a balanced oil and natural gas capital allocation, but relative valuations forced our attention to our oil exploitation business. In 2002, we emphasized building natural gas resource exploration opportunities in the form of Crown land purchases, industry farm-ins and an occasional property purchase. In 2003, natural gas drilling will emphasize exploration on our new and expanding properties in West Central Alberta, while corporate natural gas production volumes will be maintained by the continued exploration and development of our East Central Alberta properties. Zargon's large inventory of oil exploitation projects in our Southeast Saskatchewan/North Dakota core area will provide steady production gains for this and future years.

The intensity and frequency of our industry's price and cost cycles have never been greater. We will continue to respond to these cyclic challenges with a disciplined approach founded on the long-term goal of value appreciation. Reflecting the current environment of excellent commodity prices, our already strong balance sheet is likely to strengthen further in the next few months. We believe that our Company's excellent financial position combined with our robust inventory of resource opportunities will enable Zargon to continue to provide consistent solid compounded growth rates and strong equity returns to our shareholders well into the future.

ACKNOWLEDGEMENTS

We are grateful for the confidence placed in Zargon by our shareholders and we will continue to do our best to reward this trust. Our overriding objective is to enhance the value of their investment while minimizing the risk to its integrity. We acknowledge with pleasure the support and counsel of our Board of Directors and we enjoy and share the commitment of our staff, consultants and advisors to Zargon's growth and prosperity.

Respectfully submitted,



C.H. Hansen

President and Chief Executive Officer

March 17, 2003

The diverse geology, reservoirs and hydrocarbon types represented in Zargon's four core areas provide a balanced inventory of exploration and development activities for both natural gas and oil.

MAJOR PROPERTIES



Zargon's operations are divided into the following core areas of exploration and development activity:

- (A) West Central Alberta – Peace River Arch
- (B) West Central Alberta – Highvale and Pembina
- (C) East Central Alberta
- (D) Taber
- (E) Southeast Saskatchewan/North Dakota

Zargon's operations are divided into four regions of exploration and development activity. The Company's natural gas production is located in the East Central Alberta and West Central Alberta core areas, while oil production is located in the Southeast Saskatchewan/North Dakota and Taber, Alberta core areas. The diverse geology, reservoirs and hydrocarbon types represented in these areas provide Zargon a balanced inventory of exploration and development activities for both natural gas and oil. Despite their diversity, each area provides all-season shallow or medium depth drilling opportunities, which Zargon exploits by employing seismic, detailed geological analysis, reservoir engineering, and production engineering skills.

2002 CORE AREA STATISTICAL SUMMARY

	Average Production		December 31, 2002 Proven Reserves		December 31, 2002 Net Undeveloped Land	
	(boe/d)	(annual % change)	(mboe)	(annual % change)	(thousand acres)	(annual % change)
East Central Alberta	3,166	4	8,535	(4)	170.3	6
Southeast Saskatchewan	2,154	34	9,042	7	32.9	15
Taber, Alberta	414	4	1,041	(10)	19.0	52
West Central Alberta	615	26	3,253	54	109.1	185
Total	6,349	14	21,870	6	331.3	38

	Zargon Operated Production	2002 Net Capital Program	2002 Proven Finding & Development Cost	2000-2002 Total Capital Program	2000-2002 Proven Finding & Development Cost
	(%)	(\$ million)	(\$/boe)	(\$ million)	(\$/boe)
East Central Alberta	96	10.33	12.42	35.64	6.72
Southeast Saskatchewan	93	6.27	4.62	47.07	6.31
Taber, Alberta	100	2.03	52.05	14.79	16.81
West Central Alberta	62	16.92	12.43	23.75	11.45
Total	92	35.55	9.92	121.24	7.90



The East Central core area is Zargon's largest producing region, accounting for 50 percent of total production, 39 percent of total proven reserves and 51 percent of undeveloped lands.

EAST CENTRAL ALBERTA

The East Central Alberta core area is Zargon's largest producing region, accounting for 50 percent of total production, 39 percent of total proven reserves, and 51 percent of undeveloped lands. In 2002, the core area provided 86 percent of Zargon's gas production; however by year-end this rate had dropped to 78 percent as significant gas volumes from West Central Alberta properties were placed on production. The East Central Alberta properties are characterized by shallow multi-zone Cretaceous sands, located at depths from 700 to 1,200 meters, with sweet natural gas and light/medium oil reserves.

As a result of the increased emphasis on exploration in West Central Alberta properties, Zargon drilled only 10.9 net wells in the East Central Alberta core area in 2002, a 62 percent reduction from the 28.6 net wells drilled in the prior year. Despite the significantly reduced drilling program, drilling results were very good and averaged 0.53 net billion cubic feet of proven reserves per net well drilled. For the East Central Alberta area, total 2002 net capital of \$10.33 million included \$4.97 million of acquisitions primarily relating to the Ukalta producing property from the Hadrian corporate acquisition. During the year, the core area's average gas production rose by six percent to 17.51 million cubic feet per day. Year-end proven reserves declined five percent to 47.06 billion cubic feet, primarily as a result of a negative reserve revision of 4.93 billion cubic feet relating to volumetric reserve assignments for wells drilled in 2000 and 2001.

2002 ACTIVITIES

- Acquired Ukalta and other minor East Central Alberta properties as part of the Hadrian corporate acquisition.
- Shot 154 kilometers of 2-D seismic in six separate programs.
- Purchased 15.8 thousand net acres at Crown sales at an average cost of \$45 per acre.
- Drilled 13 gross wells resulting in 8.9 net gas wells and 2.0 net dry holes.
- Constructed 10.5 kilometers of pipelines, tying in nine gas wells into existing gathering systems.
- Installed field compression at three sites at the Jarrow property.

2003 PLANS

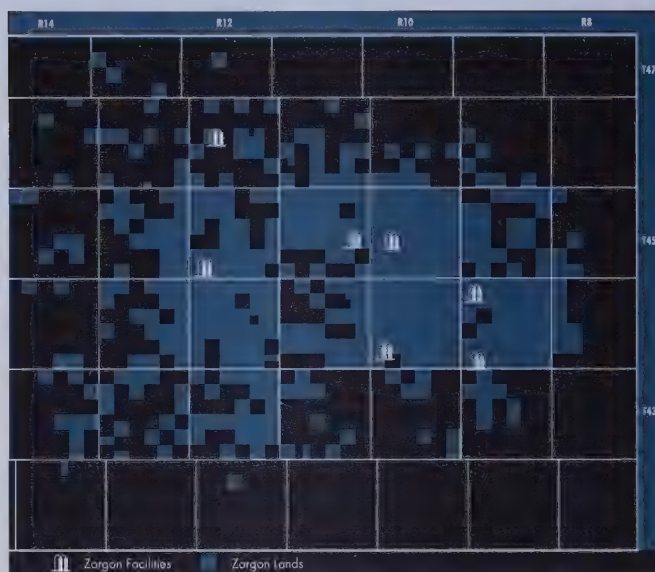
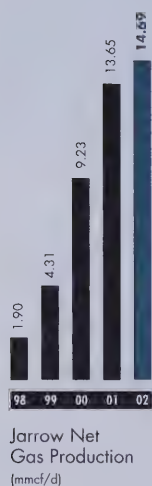
- Continue with 2-D seismic programs to identify gas exploration or development targets at existing properties.
- Drill approximately 15 gross (12 net) gas exploration or development locations, primarily at the Jarrow property.
- Continue rework, recompletion, tie-in and field compression activities to optimize the existing resource base.

Zargon's East Central Alberta production will average approximately 18 million cubic feet of natural gas per day and 210 barrels of oil per day in the first quarter of 2003. Over the next few quarters, the Company anticipates that drilling, completion and facility expenditures on existing properties will maintain or slightly increase this production rate. These East Central Alberta volumes will continue to provide a solid reserve and production foundation that supports more rigorous growth in other core areas.

EAST CENTRAL ALBERTA

	2002	2001	2000
AVERAGE PRODUCTION			
Oil (bbl/d)	248	318	406
Natural gas (mmcf/d)	17.51	16.45	12.41
TOTAL PROVEN RESERVES			
Oil (mmbbl)	693	635	923
Natural gas (bcf)	47.06	49.35	49.57
TOTAL PROVEN & PROBABLE RESERVES			
Oil (mmbbl)	866	793	1,185
Natural gas (bcf)	55.54	59.79	63.11
UNDEVELOPED LANDS			
Net acres (thousand)	170.3	161.2	165.1
DRILLING ACTIVITY			
Net wells	10.9	28.6	23.5
CAPITAL EXPENDITURES (\$ million)			
Net property acquisitions	4.97	(5.93)	2.08
Undeveloped land, seismic, geological	1.24	3.65	3.51
Drilling, completion, equipping and facilities	4.11	12.25	9.75
Total expenditures	10.33	9.97	15.34

Jarrow Property, East Central Alberta

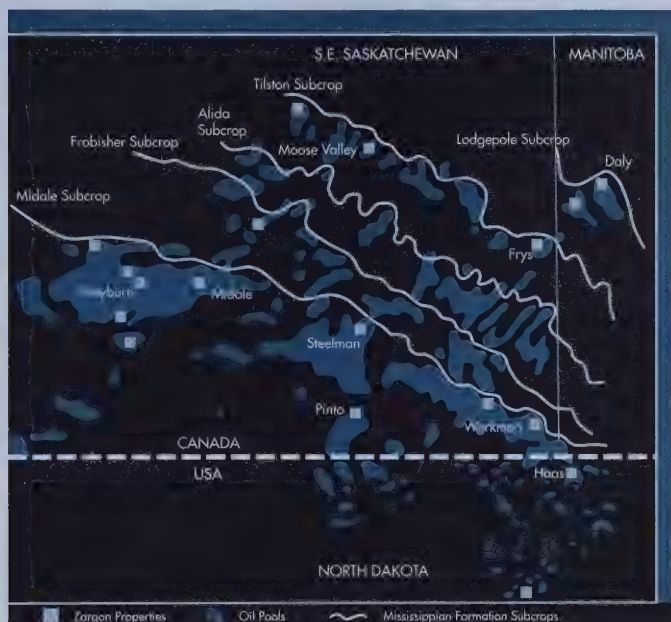


JARROW, ALBERTA

The East Central Alberta Jarrow property continues to be the Company's largest property in terms of both reserves and production. The property exemplifies Zargon's gas exploration approach, where a large undeveloped land base is acquired, then efficiently explored to create significant shareholder value. In the six year period from 1997 through 2002 Zargon's net production at Jarrow increased from 1.51 million cubic feet per day to 14.69 million cubic feet per day. These gains were made almost exclusively by drilling locations based on a comprehensive geological understanding and an extensive geophysical database. Total capital spent on the property in this six year period of \$41.23 million added 43.46 billion cubic feet of natural gas reserves at an average finding and development cost of \$0.95 per thousand cubic feet. In total 50 net gas wells and 13 net dry holes have been drilled on this property. With over 115.8 thousand net acres of undeveloped land, Zargon can continue to work the Jarrow property resource for many years to come. During 2003, Zargon plans on drilling 12 gross (10 net) seismically defined exploration and development drilling locations at the Jarrow property. It is anticipated that these wells, along with selected recompletions will maintain Zargon's net Jarrow production at a rate of 14 to 15 million cubic feet per day until mid 2004.

Zargon's Southeast Saskatchewan/North Dakota core area is its most important oil region, representing 70 percent of the Company's oil production and 80 percent of its year-end total proven oil reserves.

Southeast Saskatchewan/North Dakota Core Area



SOUTHEAST SASKATCHEWAN/NORTH DAKOTA

Zargon's Southeast Saskatchewan/North Dakota core area remains its most important oil region, and provides a solid base for the Company. In 2002, this core area represented 70 percent of the Company's oil production and 80 percent of the Company's year-end total proven oil reserves. This core area is situated in the southeast corner of Saskatchewan, the very northern portion of the state of North Dakota and in the adjacent extreme southwest corner of Manitoba. Although Zargon's properties are situated in two provinces and one state, they are located within a one hundred mile radius of Estevan, Saskatchewan and they all have very similar reservoir and geological characteristics with light and medium oil reserves produced from Mississippian carbonate reservoirs at depths ranging from 950 to 1,500 meters.

The area's complex geology offers significant reservoir and/or geological related exploitation opportunities. Zargon's business plan for the area is defined by disciplined property acquisitions followed by reservoir/geological related optimizations and modifications designed to increase reserves/production or improve profitability. These operations include seismic pool delineation, vertical and horizontal exploitation drilling, waterflood modifications, waterflood implementations or battery consolidations. The Company has an

inventory of 12 waterflood and five exploitation projects currently in progress. These projects, which are at various stages of implementation, contain over 102 million barrels of working interest oil-in-place that provides the feedstock for profitable production and reserve growth.

The \$6.27 million Southeast Saskatchewan/North Dakota 2002 capital program represented an 81 percent reduction from the very large 2001 capital program that was highlighted by the Herc corporate acquisition. Despite the smaller capital program, in 2002 Zargon increased proven reserves seven percent to 8.90 million barrels of oil, through a very successful Haas Unit waterflood enhancement program. Significant progress was also made on many of the smaller optimization projects that should yield positive reserve and production growth for many quarters. Zargon's 2002 production in the Southeast Saskatchewan core area averaged 2,074 barrels of oil per day, a 32 percent improvement over the prior year.

In 2003, Zargon is budgeting for a very active year for Southeast Saskatchewan/North Dakota. Expenditures will continue to emphasize the development of Zargon's considerable inventory of exploitation opportunities.

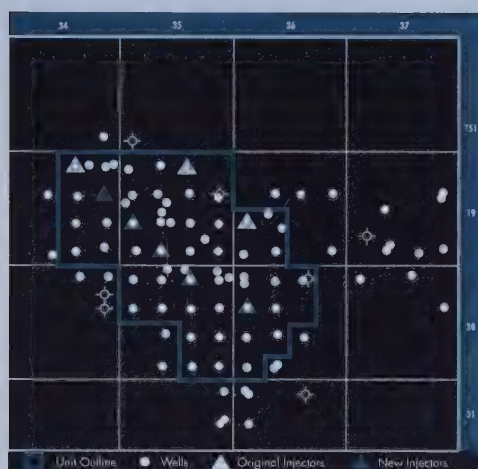
2002 ACTIVITIES

- Concluded six property purchases relating to waterflood exploitation opportunities at Frys, Steelman and Weyburn, Saskatchewan. These purchases were partially offset with the fourth quarter sale of five higher cost Saskatchewan properties. The net result was a 2002 acquisition expenditure of \$1.20 million.
- Shot nine square kilometers of 3-D and 30 kilometers of 2-D seismic to assist in the development of various Saskatchewan and North Dakota properties.
- Purchased 2.8 thousand net acres at Saskatchewan Crown sales at an average cost of \$55 per acre.
- Drilled four (3.9 net) oil wells at Weyburn, Saskatchewan and Haas, North Dakota. This program included one (0.9 net) horizontal development location at Weyburn, Saskatchewan.
- Implemented a secondary recovery project by water injections in the Tilston formation at Frys, Saskatchewan.
- In August 2002, Zargon received approval from the North Dakota Industrial Commission to modify the Haas Unit waterflood project with the conversion of five wells into injectors. Since the fieldwork was completed in early October 2002, over 4,000 barrels per day of incremental water has been injected into the Haas Glenburn formation. Oil production has subsequently increased 38 percent from an average third quarter 2002 rate of 501 barrels per day to a February 2003 rate of 690 barrels per day.

2003 PLANS

- Accelerate exploitation and development drilling operations with nine net wells budgeted at the Forget, Haas, Manor, Pinto, Weyburn, and Workman properties.
- Enhance, initiate or modify Southeast Saskatchewan waterfloods at Frys, Steelman, Workman and Weyburn.

Hass Unit, North Dakota



- Expand on the Haas, North Dakota operating platform to build exploitation drilling and waterflood opportunities in the state of North Dakota.

Production from this core area is expected to average 2,175 barrels of oil per day and 0.40 million cubic feet of gas per day in the first quarter of 2003. It is anticipated that production will climb throughout the year, as volumes from horizontal/vertical exploitation drilling and waterflood implementations more than offset the area's shallow production declines.

SOUTHEAST SASKATCHEWAN/NORTH DAKOTA

	2002	2001	2000
AVERAGE PRODUCTION			
Oil (bbl/d)	2,074	1,569	971
Natural gas (mmcf/d)	0.46	0.25	0.09
TOTAL PROVEN RESERVES			
Oil (mmbbl)	8,899	8,323	4,065
Natural gas (bcf)	0.85	0.89	0.49
TOTAL PROVEN & PROBABLE RESERVES			
Oil (mbl)	10,624	10,350	5,460
Natural gas (bcf)	1.00	1.09	0.65
UNDEVELOPED LANDS			
Net acres (thousand)	32.9	28.6	25.9
DRILLING ACTIVITY			
Net wells	3.9	3.1	4.9
CAPITAL EXPENDITURES (\$ million)			
Net property acquisitions	1.20	28.41	4.32
Undeveloped land, seismic, geological	0.90	1.49	0.83
Drilling, completion, equipping and facilities	4.17	2.98	2.77
Total expenditures	6.27	32.88	7.92

The **Taber** property, Zargon's smallest core area, is characterized by a complex series of relatively thick medium-gravity oil-bearing sandstones at a depth of approximately 1,000 meters.

TABER, ALBERTA

The Taber property, Zargon's smallest core area, is characterized by a complex series of relatively thick medium-gravity oil-bearing sandstones at a depth of approximately 1,000 meters. Following a very active, but relatively disappointing 2001 exploratory drilling program, Zargon proceeded with a modest development program in 2002 focused on infill and delineation wells. In 2003, the Taber capital program will be directed to engineering activities designed to maximize oil and solution gas reserves from the more than 12 million barrels of working interest oil-in-place situated on the property.

2002 ACTIVITIES

- Purchased 4.0 thousand net acres through private and Crown sales at an average cost of \$47 per acre.
- Drilled four (4.0 net) wells resulting in three net oil wells and one gas well.

2003 PLANS

- Drill one horizontal development well. A successful well could lead to a multi-well horizontal exploitation program.
- Modify one existing waterflood project and initiate one waterflood project.
- Install gathering and compression facilities to conserve solution gas and uphole non-associated gas reserves.
- Upgrade pumping, water disposal and battery facilities to implement a high volume lift depletion strategy for selected producers.

It is anticipated that first quarter 2003 production will average about 400 barrels of oil per day. This rate should climb throughout the year as capital programs are implemented.

TABER, ALBERTA

	2002	2001	2000
AVERAGE PRODUCTION			
Oil (bbl/d)	412	398	189
Natural gas (mrcf/d)	0.01	—	—
TOTAL PROVEN RESERVES			
Oil (mmbbl)	983	1,113	953
Natural gas (bcf)	0.35	0.24	—
TOTAL PROVEN & PROBABLE RESERVES			
Oil (mmbbl)	1,588	1,713	1,458
Natural gas (bcf)	0.49	0.41	—
UNDEVELOPED LANDS			
Net acres (thousand)	19.0	12.5	4.0
DRILLING ACTIVITY			
Net wells	4.0	12.0	0.6
CAPITAL EXPENDITURES (\$ million)			
Net property acquisitions	0.23	1.03	3.09
Undeveloped land, seismic, geological	0.24	2.54	1.12
Drilling, completion, equipping and facilities	1.56	4.61	0.36
Total expenditures	2.03	8.18	4.58



In 2002, Zargon experienced real success in building a new West Central Alberta core area that will provide meaningful natural gas production reserve growth in the medium and longer term.

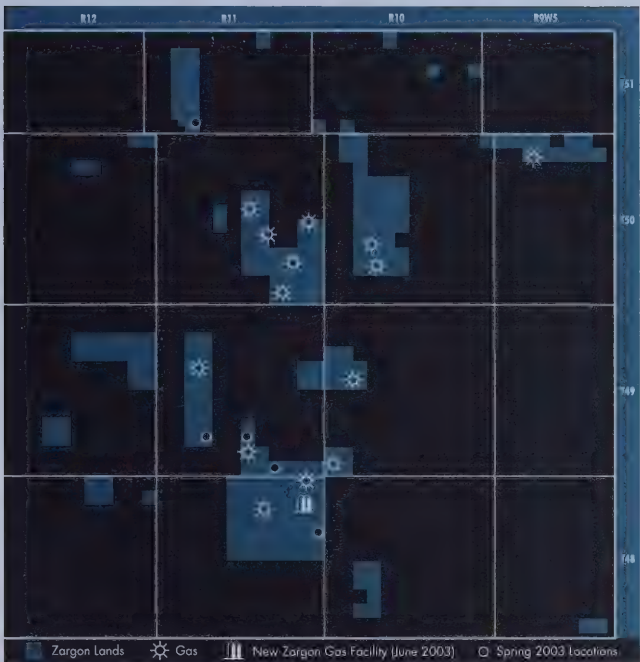
WEST CENTRAL ALBERTA

In 2002, Zargon experienced real success in building a new core area that will provide meaningful natural gas production and natural gas reserve growth in the medium and longer term in West Central Alberta. During the year, the West Central Alberta undeveloped land inventory was almost tripled to 109.1 thousand net acres through Crown and private land purchases; the Hadrian acquisition introduced natural gas exploration opportunities that were successfully drilled; and a successful drilling and land acquisition program furthered the Pembina shallow natural gas project. By year-end the success of these initiatives became evident, with natural gas production in the West Central Alberta core area increasing to 4.90 million cubic feet in December 2002 from 1.62 million cubic feet per day in January 2002.

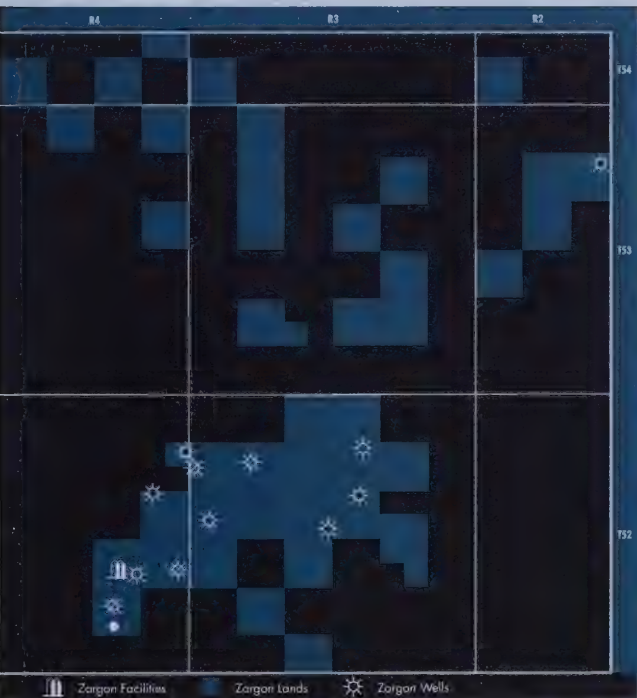
During the year, significant progress was made on each of three independent West Central Alberta natural gas exploration initiatives. The Pembina shallow natural gas program was continued from the previous year with the drilling of 6.3 net natural gas wells. The program is characterized by shallow, potentially natural gas-bearing Edmonton sands at depths ranging up to 900 meters. Production rates are varied, but can exceed 0.50 million cubic feet of natural gas per day. Through Crown sales, private sales and farm-ins, Zargon has assembled over 28.1 thousand net acres of undeveloped land on this play concept. In June 2003, approximately 2.0 million cubic feet per day of production is scheduled to be tied-in with further work, including the drilling of ten net wells and additional tie-ins, planned by year-end.

The Hadrian corporate acquisition brought some East Central Alberta natural gas production, but more importantly, it also provided natural gas exploration opportunities at Judy Creek and Highvale in West Central Alberta. Zargon subsequently drilled three natural gas wells on the Highvale property, that have been pipeline connected and are currently producing at a rate of 5.4 million cubic feet of natural gas per day (3.2 million cubic feet of natural gas per day net to the Zargon interest). In addition to the exploration locations, the acquisition of the Highvale property brought Zargon an operated 30 percent interest in the area's natural gas processing and compression facility. In 2003, Zargon will continue to explore its 18.1 thousand net acres in the immediate Highvale area.

Pembina Property, West Central Alberta



Highvale Property, West Central Alberta



In 2002, Zargon continued to build a "grass roots" gas exploration program in the Peace River Arch region of West Central Alberta. To accomplish this strategy, Zargon posted Crown lands, purchased or shot seismic and completed detailed geological analyses of the area. By year-end, a total of 45.2 thousand net acres of undeveloped land had been acquired on six separate natural gas exploration prospects in the Peace River Arch area. The prospects are generally all-season access with multi-zone targets at depths of less than 1,800 meters.

During 2002, one net dry hole was drilled at Dunvegan. In 2003, Zargon will further evaluate these Peace River Arch prospects, which offer high reward, but also higher risk, natural gas reserves. Additional Crown land purchases will be made, seismic will be shot and a minimum of five exploration locations will be drilled in 2003, however production from these "grass roots" exploration initiatives is not expected until 2004.

Although the West Central Alberta core area is primarily a natural gas exploration region, Zargon continually seeks to acquire exploitable oil properties in areas that complement the natural gas exploration business. To this end, in 2002 Zargon acquired an operated Pembina Belly River oil pool in West Central Alberta for \$3.50 million. The acquisition brought 13 million barrels of working interest oil-in-place that will be exploitable with the implementation of a waterflood.

WEST CENTRAL ALBERTA

	2002	2001	2000
AVERAGE PRODUCTION			
Oil (bbl/d)	234	156	159
Natural gas (mmcf/d)	2.31	1.97	1.99
TOTAL PROVEN RESERVES			
Oil (mmbbl)	539	409	399
Natural gas (bcf)	16.28	10.25	9.10
TOTAL PROVEN & PROBABLE RESERVES			
Oil (mmbbl)	698	567	573
Natural gas (bcf)	20.85	12.96	11.72
UNDEVELOPED LANDS			
Net acres (thousand)	109.1	38.4	18.1
DRILLING ACTIVITY			
Net wells	12.8	4.1	9.6
CAPITAL EXPENDITURES (\$ million)			
Net property acquisitions	5.25	0.48	(0.14)
Undeveloped land, seismic, geological	4.55	1.20	0.53
Drilling, completion, equipping and facilities	7.12	2.47	2.29
Total expenditures	16.92	4.15	2.68

In 2003, Zargon will proceed with an active West Central Alberta natural gas exploration program on the Pembina shallow, greater Highvale and Peace River Arch land blocks.

2002 ACTIVITIES

- Acquired Highvale, Judy Creek and other natural gas exploration properties as part of the Hadrian corporate acquisition.
- Acquired a Pembina Belly River oil exploitation property for \$3.50 million. This acquisition was partially offset by the sale of one medium-heavy gravity oil property for \$1.20 million.
- Drilled seven (6.3 net) natural gas wells at Pembina exploring for shallow natural gas reservoirs.
- Drilled six (5.5 net) wells, resulting in 5.5 net natural gas wells (4.3 net wells after casing point elections) on the ex-Hadrian and related properties of Highvale, Judy Creek and Gunn, Alberta.
- Drilled one (1.0 net) exploratory dry hole at Dunvegan exploring for higher risk but large upside natural gas accumulations on the Peace River Arch undeveloped land inventory.
- Purchased 300 kilometers and shot 41 kilometers of 2-D seismic.
- Purchased 50.0 thousand net acres at Crown sales at an average cost of \$63 per acre.
- Constructed 16.8 kilometers of pipelines, tying in five natural gas wells into existing gathering systems.

2003 PLANS

- Drill 10 net wells pertaining to the Pembina shallow natural gas exploration project. Construct compression and gathering facilities to tie-in the South Pembina shut-in natural gas wells. Additional Pembina shallow well tie-ins are projected by year-end.
- Upgrade Highvale compression facilities to expand production. Evaluate an expanded area land base with three net exploration wells.
- Explore and expand Peace River Arch undeveloped land inventory by drilling five net exploration wells. Success will lead to additional locations.
- Continue to acquire West Central Alberta lands on the Pembina shallow natural gas, greater Highvale area and Peace River Arch natural gas exploration initiatives.
- Implement a Belly River waterflood at Pembina, Alberta.

In the first quarter of 2003, production from the West Central Alberta core area is expected to average approximately 5.5 million cubic feet of natural gas per day and 250 barrels of oil per day. Mid-year tie-ins at Pembina should add an additional 2.0 million cubic feet per day with additional natural gas volumes at Pembina and Highvale anticipated by year-end.

In 2002, Zargon delivered another year of solid operating results. The year was highlighted by a 38 percent increase in the Company's undeveloped land inventory; a 14 percent increase in average production and a six percent gain in total proven reserves.

ACTIVITY REVIEW

HIGHLIGHTS

In 2002, Zargon delivered another year of solid operating results. The year was highlighted by a 38 percent increase in the Company's undeveloped land inventory to 331.3 thousand net acres; a 14 percent increase in average production to 6,349 barrels of equivalent per day and a six percent gain in total proven reserves to 21.87 million barrels of equivalent.

	2002	2001	Percent Change
Undeveloped land (thousand net acres)	331.3	240.7	38
Wells drilled, net	31.6	47.7	(34)
Natural gas production (mmcf/d)	20.29	18.67	9
Oil and liquids production (bbl/d)	2,968	2,441	22
Year-end proven natural gas reserves (bcf)	64.54	60.74	6
Year-end proven oil reserves (mmbbl)	11,114	10,482	6

LAND AND SEISMIC

Zargon's undeveloped land inventory increased 38 percent in 2002 to 331.3 thousand net acres. During the year, lower Crown sale prices provided Zargon with a rare opportunity to substantially build its inventory of natural gas prospective undeveloped lands at reasonable costs. The year's acquisitions were primarily focused on natural gas opportunities in the West Central Alberta core area, where Zargon's undeveloped land inventory almost tripled to 109.1 thousand net acres. By year-end, Zargon's deliberate focus on high interest operated properties had resulted in an increase of the average undeveloped land working interest to 84 percent from the previous high of 82 percent recorded at year-end 2001.

During the year, the Company spent \$4.46 million on expanding and maintaining the undeveloped land inventory. Crown sale acquisitions of 72.5 thousand net acres totalled \$4.20 million for an average cost of \$58 per acre. This acreage cost was substantially lower than the prior year's Crown sale purchases of 48.5 thousand net acres for \$4.60 million or \$95 per acre.

In addition to Crown purchases, undeveloped lands were also acquired in the Hadrian corporate acquisition, through undeveloped land purchases from other industry participants, and through a freehold leasing program. The independent firm Seaton Jordan & Associates Ltd. ("Seaton Jordan") has valued Zargon's undeveloped land holdings as of December 31, 2002 at \$22.37 million, up 21 percent from last year's \$18.47 million appraisal. This analysis incorporates an average undeveloped acreage price of \$68 per acre, compared to the 2001 and 2000 respective estimates of \$77 and \$70 per acre.



Undeveloped Land
(thousand net acres)

As part of Zargon's continuing exploration focus, the Company shot 225 kilometers and purchased 492 kilometers of 2-D seismic in 2002. Over nine square kilometers of 3-D seismic surveys were also conducted on oil exploitation projects in Southeast Saskatchewan. Total geological and geophysical costs in 2002 were \$2.47 million as compared to the prior year's expenditure of \$3.80 million. Capital expenditures for undeveloped land and seismic during the year totalled \$6.93 million, or 19 percent of the 2002 capital program as compared to \$8.88 million in 2001 which equated to 16 percent of the total expenditures.

UNDEVELOPED LAND, NET ACRES

As at December 31 (thousand net acres)	2002	2001	2000
Alberta	298.3	212.0	187.2
Saskatchewan	32.3	28.1	25.3
Manitoba	0.7	0.6	0.6
Total	331.3	240.7	213.1
Average Zargon working interest (%)	84	82	79

DRILLING, COMPLETION AND WORKOVERS

Zargon drilled a total of 31.6 net wells in 2002, a 34 percent decrease in activity from 2001. In the relatively low commodity price environment of the first half of 2002, Zargon focused on expanding its inventory of gas exploration opportunities, drilling only 7.1 net wells. As commodity prices improved in the second half of the year activity was stepped up with 24.5 net wells drilled, taking the year's total to 31.6 net wells. The 2002 program resulted in 20.7 net natural gas wells, 6.9 net oil wells, and 4.0 net dry holes.

DRILLING ACTIVITY

Number of Wells	2002		2001		2000	
	Gross	Net	Gross	Net	Gross	Net
Oil	7	6.9	14	11.1	11	6.9
Natural Gas	24	20.7	30	22.7	32	26.0
Service	-	-	-	-	1	0.4
Dry	4	4.0	14	13.9	6	5.3
Total	35	31.6	58	47.7	50	38.6
Exploratory	26	23.0	41	37.2	31	26.1
Development	9	8.6	17	10.5	19	12.5
Total	35	31.6	58	47.7	50	38.6
Alberta	31	27.7	52	44.6	44	33.7
Saskatchewan	3	2.9	6	3.1	6	4.9
North Dakota, USA	1	1.0	-	-	-	-
Total	35	31.6	58	47.7	50	38.6
Average net Zargon working interest (%)	90		82		77	



Drilling Activity
(net wells)

Zargon's success ratio was 87 percent for its 2002 drilling program, a marked improvement over the prior year's 71 percent success ratio. This improved success ratio was achieved through the implementation of a disciplined capital allocation process while still maintaining a 73 percent weighting to exploration wells.



Production
(boe/d)

In deploying the Company's strategy of operated focused programs, Zargon's average working interest for the year's drilling program was 90 percent, with 34 of the 35 gross wells operated by the Company. More than 75 percent of the year's drilling activities related to gas targets, relatively evenly divided between East Central and West Central Alberta projects. Currently very strong commodity prices support expanded natural gas and oil development drilling programs in 2003 and during the upcoming year, 40 net wells are planned, emphasizing gas exploration in West and East Central Alberta and oil exploitation in Southeast Saskatchewan/North Dakota.

In 2002, as a result of the 34 percent reduction in net wells, expenditures for drilling, completion and workovers totalled \$12.49 million, a 28 percent decrease from the \$17.44 million spent in 2001. Expenditures were six percent higher on a per well basis due to an increase in average drilling depths as Zargon began to drill some of its deeper West Central Alberta gas exploration targets. Drilling related expenditures represented a 35 percent share of the year's total capital program, a small increase from the 32 percent recorded in the prior year.

PRODUCTION EQUIPMENT AND FACILITIES

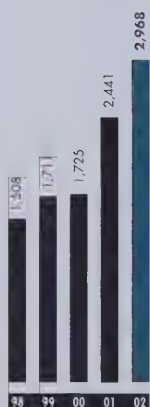
Zargon spent \$4.48 million on gas plant expansion and construction, oil battery modifications and construction and the installation of approximately 32 kilometers of pipelines in 2002. This is an eight percent decrease over the prior year's expenditures of \$4.87 million and represented 13 percent of the 2002 total capital program, up substantially from the prior year's nine percent allocation. During the year, larger facility projects included the implementation of an expanded waterflood at the Haas property in North Dakota, new gas well tie-ins at the West Central Alberta Highvale and Judy Creek properties, and ongoing tie-ins relating to the exploration and development drilling at the Jarrow gas property in East Central Alberta.

PROPERTY ACQUISITIONS

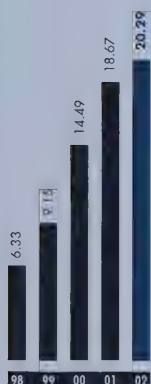
Zargon's total net corporate and property acquisitions totalled \$11.65 million or 33 percent of the Company's total 2002 capital expenditures. The majority of these expenditures related to the June 17, 2002 corporate acquisition of Hadrian Energy Corp. The Hadrian acquisition provided West Central Alberta gas exploration opportunities and substantial tax planning benefits. The acquisition was accounted for by the purchase method with \$7.39 million assigned to the property and equipment accounts. The 2002 acquisition expenditures represented a 51 percent decrease from the \$23.99 million spent in 2001, which was dominated by the corporate acquisition of Herc Oil Corp.

During 2002, Zargon completed 14 property acquisitions for a total of \$7.39 million. The largest of these was a \$3.50 million purchase of an exploitable Pembina Belly River oil pool in West Central Alberta. The remaining purchases generally related to the expansion of existing interests pertaining to Southeast Saskatchewan oil exploitation projects.

By the fourth quarter of 2002, the property acquisition market had firmed considerably. To capture the benefits of this strong market, Zargon sold 17 minor properties in a total of ten transactions for \$3.13 million. The sale properties, which had mostly been acquired in recent corporate acquisitions, were either very small, were medium-heavy oil properties or had high operating costs. The sales are consistent with Zargon's policy of selling non-strategic assets when good prices are available. Further minor property sales are anticipated in the first half of 2003.



Oil and Liquids
Production
(bbl/d)



Natural Gas Production
(mmcf/d)

PRODUCTION

Natural gas sales volumes increased nine percent in 2002 to average 20.29 million cubic feet per day compared to 18.67 million cubic feet per day in 2001 (2000 – 14.49 mmcf/d). Increases in natural gas production were primarily derived from properties acquired in the Hadrian corporate acquisition. Crude oil and natural gas liquid production increased 22 percent in 2002 to average 2,968 barrels per day compared to 2,441 barrels per day in 2001 (2000 – 1,725 bbl/d). The majority of these gains originated from the mid-year 2001 Herc corporate acquisition.

Zargon's 2002 average daily production climbed 14 percent, to 6,349 barrels of equivalent per day compared to 5,553 barrels of equivalent per day in 2001 (2000 – 4,140 boe/d). During the year natural gas production represented 53 percent of total volumes, down slightly from a 57 percent weighting in 2001. Natural gas production gains coming from the successful 2002 exploration program have returned the current natural gas production weighting to more than 57 percent.

RESERVES

Zargon's 2002 capital investment program provided proven oil and natural gas reserve additions that replaced 2002 production volumes by 158 percent and 151 percent, respectively. On an equivalent basis, Zargon's total proven reserves climbed six percent during 2002 to 21.87 million barrels of equivalent up from 20.61 million barrels of equivalent. Proven and probable reserves also increased four percent to a year-end estimate of 26.76 million barrels of equivalent. The Company's proven oil and liquid reserves had increased six percent to 11.11 million barrels at year-end 2002, as compared to 10.48 million barrels at year-end 2001. Natural gas reserves also increased six percent to 64.54 billion cubic feet from 60.74 billion cubic feet reported at the end of 2001.

Zargon's 2002 year-end crude oil, liquids and natural gas reserves were evaluated by McDaniel & Associates Consultants Ltd. ("McDaniel") who have conducted an annual independent review of 100 percent of the Company's reserves since 1993.

COMPANY RESERVES

At December 31, 2002 (before royalties)	Oil and Liquids	Natural Gas	Equivalents
	(mbbl)	(bcf)	(mboe)
Proven producing	10,907	43.28	18,120
Proven non-producing	187	20.29	3,569
Proven undeveloped	20	0.96	180
Total proven	11,114	64.54	21,870
Probable additional	2,663	13.34	4,886
Total proven and probable	13,776	77.88	26,756
Proven reserve life index, years	10.0	7.9	8.9
Proven and probable reserve life index, years	12.4	9.6	10.8



Proven Reserves
(mboe)

Approximately 83 percent of Zargon's total proven reserves are allocated to the proven producing category. Proven non-producing reserves are comprised primarily of natural gas reserves from recently drilled wells at Pembina, behind pipe natural gas reserves at Jarow and from unconnected natural gas wells at the more



Proven and Probable Reserves (mboe)



Proven Oil and Liquid Reserves (mmbbl)

remote Sturgeon Lake property. Proven undeveloped reserves represent less than one percent of the total proven reserves. McDaniel forecasts \$6.04 million of net unescalated future capital costs to deliver the total proven reserve estimate. Zargon's probable reserves generally reflect incremental waterflood recoveries on producing oil properties and improved gas recovery factors for currently producing gas wells. Eighty-two percent of the Company's reserves were classified as proven, compared to 80 percent and 76 percent in 2001 and 2000.

Based on yearend reserves, and the fourth quarter 2002 production rates of 3,043 barrels of oil per day and 22.26 million cubic feet per day of natural gas, Zargon's proven reserve life index is 10.0 years and 7.9 years for oil and natural gas, respectively. The corresponding proven and probable oil and natural gas reserve life indices are 12.4 and 9.6 years. The relatively high oil reserve life reflects Zargon's portfolio of long-life shallow-decline Southeast Saskatchewan/North Dakota waterflood projects.

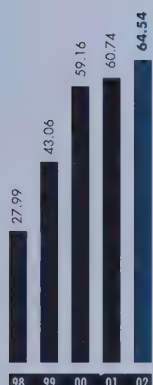
RESERVE RECONCILIATION

A reconciliation of Zargon's proven and probable reserves is provided below for the years 2000 through 2002:

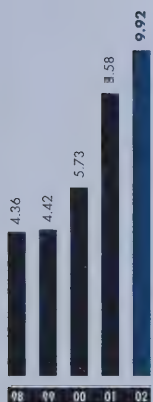
RESERVE RECONCILIATION

	Oil and Liquids (mmbbl)			Natural Gas (bcf)			Equivalents (mboe)		
	Proven	Probable	Total	Proven	Probable	Total	Proven	Probable	Total
December 31, 1999	5,211	1,880	7,091	43.06	11.79	54.85	12,388	3,845	16,233
Discoveries & extensions	395	164	559	19.44	4.32	23.76	3,635	882	4,517
Technical revisions	484	47	531	0.82	0.26	1.08	620	90	710
Acquisitions/dispositions	883	246	1,128	1.13	(0.03)	1.10	1,071	241	1,312
Production	(632)	—	(632)	(5.30)	—	(5.30)	(1,515)	—	(1,515)
December 31, 2000	6,340	2,337	8,677	59.16	16.32	75.48	16,200	5,056	21,256
Discoveries & extensions	492	73	565	11.39	1.12	12.51	2,390	259	2,650
Technical revisions	149	(102)	47	(1.60)	(3.40)	(5.00)	(118)	(669)	(786)
Acquisitions/dispositions	4,391	624	5,015	(1.39)	(0.49)	(1.88)	4,159	542	4,700
Production	(891)	—	(891)	(6.82)	—	(6.82)	(2,027)	—	(2,027)
December 31, 2001	10,482	2,930	13,413	60.74	13.55	74.28	20,605	5,188	25,793
Discoveries & extensions	1,427	163	1,590	11.64	1.92	13.56	3,367	483	3,850
Technical revisions	181	(440)	(259)	(5.62)	(3.27)	(8.89)	(756)	(985)	(1,741)
Acquisitions/dispositions	107	10	117	5.19	1.14	6.33	972	200	1,172
Production	(1,083)	—	(1,083)	(7.41)	—	(7.41)	(2,318)	—	(2,318)
December 31, 2002	11,114	2,663	13,776	64.54	13.34	77.88	21,870	4,886	26,756
Percent change									
2002/2001	6	(9)	3	6	(2)	5	6	(6)	4

Proven 2002 reserve additions totalled 3,583 thousand barrels of equivalent. Discoveries and extensions relating to field capital exploration and development programs totalled 3,367 thousand barrels of equivalent and accounted for 94 percent of the total proven reserve additions. Corporate and property acquisitions of 972 thousand barrels of equivalent contributed an additional 27 percent to the 2002 additions. These gains were reduced by a negative 21 percent adjustment of the total reserve additions to reflect negative proven reserve revisions of 756 thousand barrels of equivalent.



Proven Natural Gas Reserves (bcf)



Proven Finding and Development Costs (\$/boe)

Consistent with prior years, Zargon's oil reserves showed a small positive adjustment of 181 thousand barrels as a result of additional reserve recognition for the ongoing Southeast Saskatchewan waterflood projects. However, proven gas reserves were revised downwards by 5.62 billion cubic feet on certain wells in East Central Alberta on the periphery of the Jarrow property, at Ukalta and at Hamilton Lake. In most cases, the adjustments related to wells drilled in 2000 or 2001 that were assigned reserves in the December 2001 engineering evaluation on a volumetric basis, as there was only very limited production histories available for analysis. Subsequent production histories did not support the full measure of these assignments and the necessary reserve adjustments have been booked in the 2002 year-end report.

FINDING AND DEVELOPMENT COSTS

Zargon's 2002 capital gas program totalled \$23.07 million and delivered 11.21 billion cubic feet of natural gas (16.83 billion cubic feet before revisions) for a proven development and finding cost of \$2.06 per thousand cubic feet (\$1.37 per thousand cubic feet before revisions). The proven natural gas additions came through the Hadrian corporate acquisition and exploration drilling activities, primarily at the West Central Alberta Highvale and Pembina properties and at the East Central Alberta Jarrow property.

During the year Zargon spent \$12.48 million on oil projects and added 1,715 thousand barrels of proven oil reserves for a finding cost of \$7.28 per barrel. These additions were generated primarily from Southeast Saskatchewan and North Dakota exploitation activities.

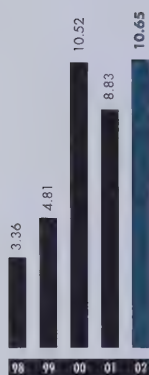
Zargon's proven 2002 finding and development costs were \$9.92 per barrel of equivalent. These costs compare with the proven three and five year finding and development costs of \$7.90 and \$6.84 per barrel of equivalent, respectively.

The proven gas reserve revisions are essentially a correction of volumetric-based reserves assigned to 2000 and 2001 drilling programs. Excluding revisions, the 2002 capital program added proven reserves of 4,339 thousand barrels of equivalent with a finding and development costs of \$8.19 per barrel of equivalent. These before revision costs are attributed \$11.99 per barrel of equivalent to property and corporate acquisitions and \$7.10 per barrel of equivalent to field related exploration and development activities.

In summary, Zargon experienced higher finding and development costs in 2002 due to a combination of factors: East Central Alberta gas reserve revisions; West Central Alberta seismic and land acquisition costs incurred for future exploration activities; and generally higher industry-wide costs. Excluding the 2002 proven reserve revisions, Zargon's finding and development cost dropped four percent from the prior year's level but remained substantially higher than in the 1990's when industry input costs were less but commodity prices were much lower.

FINDING AND DEVELOPMENT COSTS

	2002	2001	2000	Three Year Total	Five Year History	Eleven Year History
Net capital expenditures (\$ million)	35.55	55.18	30.51	121.24	150.67	190.10
Reserve additions after revisions (mboe)						
Proven	3,583	6,431	5,327	15,342	22,036	32,134
Proven and probable	3,281	6,564	6,541	16,386	24,645	37,396
Finding and development costs (\$/boe)						
Proven	9.92	8.58	5.73	7.90	6.84	5.92
Proven and probable	10.84	8.41	4.66	7.40	6.11	5.08



Net Asset Value
(PVBT 12%)
(\$/diluted share)

NET ASSET VALUE

The following tables summarize the December 31, 2002 McDaniel forecast of cash flow derived from the production and sale of working and royalty interest reserves prior to the deduction of interest, income tax, general and administrative or other corporate costs.

DISCOUNTED CASH FLOWS

(\$ million)	Discount Factor			
	0%	10%	12%	15%
Proven producing	243.4	164.6	155.1	143.0
Proven non-producing	58.4	33.9	31.0	27.4
Proven undeveloped	2.2	1.3	1.2	1.0
Total proven	304.0	199.8	187.3	171.5
Probable (risked at 50%)	38.0	15.6	13.6	11.3
Total proven plus 50% risked probable	342.0	215.3	200.9	182.8

MCDANIEL REPORT PRICE FORECAST

	WTI Crude Oil (\$/US/bbl)	Henry Hub Gas Price (\$/US/mmbtu)
2003	26.00	4.08
2004	24.00	3.81
2005	22.90	3.63
2006	22.80	3.58
2007	23.30	3.66
2008	23.80	3.69
Thereafter:	Escalate at US \$0.50/bbl per year	Escalate at US \$0.08/mmbtu per year

The following estimate of Zargon's net asset value is calculated using a McDaniel 12 percent discounted pretax value for proven and risked probable reserves and a Seaton Jordan undeveloped land value estimate.

NET ASSET VALUE

As at December 31 (\$ million)	2002	2001	2000	1999	1998
Proven reserves ⁽¹⁾	187.3	149.9	150.7	69.0	45.6
Probable reserves (risked) ⁽²⁾	13.6	12.9	13.5	8.1	5.1
Undeveloped land ⁽³⁾	22.4	18.5	14.9	9.8	6.3
Working capital	(3.5)	(3.5)	(2.5)	(0.1)	(0.2)
Bank debt	(25.3)	(24.1)	(15.9)	(14.1)	(6.2)
Net asset value	194.5	153.7	160.7	72.7	50.6
Net asset value per common share outstanding (\$/share)	11.03	9.22	11.22	5.04	3.42
Net asset value per diluted common share (\$/share)	10.65	8.83	10.52	4.81	3.36

⁽¹⁾ McDaniel estimate of future before tax cash flow discounted at PV 12 percent

⁽²⁾ McDaniel PV 12 percent estimate after reduction for 50 percent risk

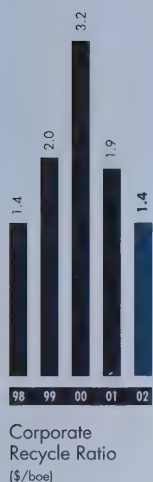
⁽³⁾ Seaton Jordan year-end estimates

CORPORATE PERFORMANCE

Throughout its history, Zargon has targeted a benchmark of greater than 15 percent compounded annual growth in per share proven reserves, production, cash flow and earnings. Over its eleven year history, Zargon



Return on Equity
(%)



has delivered an average composite growth rate of 22 percent per share for these four parameters. For the non-commodity price sensitive parameters of proven reserves and production per share, eleven and five year compounded annual growth rates have averaged 16 and 17 percent, respectively.

CORPORATE GROWTH

	2002	2001	2000	1999	1998	1992	Last Year's Growth (2001-2002)	Five Year Annual Growth (1998-2002)	Eleven Year Annual Growth (1992-2002)
Proven reserves (mboe) ⁽¹⁾ ⁽⁴⁾	21,870	20,605	16,200	12,387	9,736	1,000	6	22	36
Boe per share ⁽¹⁾ ⁽⁴⁾	1.24	1.24	1.13	0.86	0.66	0.25	—	17	17
Production (boe/d) ⁽⁴⁾	6,349	5,553	4,140	3,236	2,563	362	14	26	33
Boe/d per million shares ⁽²⁾ ⁽⁴⁾	368	357	287	224	196	89	3	17	15
Cash flow (\$ million)	32.12	32.67	27.50	10.64	5.82	0.55	(2)	53	50
\$/share ⁽³⁾	1.81	2.03	1.86	0.70	0.43	0.16	(11)	43	27
Earnings (\$ million)	10.68	13.14	11.26	4.26	1.25	0.14	(19)	71	54
\$/share ⁽³⁾	0.60	0.82	0.76	0.29	0.10	0.05	(27)	56	28
Average shares outstanding (million)	17.23	15.56	14.41	14.69	13.03	4.05	11	7	16
Year-end shares outstanding (million)	17.64	16.67	14.32	14.42	14.81	4.05	6	5	16
Year-end share price (\$)	9.00	7.20	4.45	3.00	2.40	N/A	25	39	22 ⁽⁵⁾
Four parameter average									
annual growth (%) ⁽⁶⁾	—	24	96	92	(11)	—	—	43	43
Four parameter average									
annual growth per share (%) ⁽⁶⁾	(9)	13	91	72	(18)	—	(9)	33	22

Notes:

- ⁽¹⁾ Reserves per share are calculated using year-end reserve appraisals and year-end shares outstanding.
- ⁽²⁾ Production per share is calculated using year average production and weighted average shares outstanding for the year
- ⁽³⁾ Cash flow and earnings per share are presented on a weighted average diluted basis
- ⁽⁴⁾ Assumes six thousand cubic feet of natural gas is equivalent to one barrel of oil.
- ⁽⁵⁾ Share price growth rate since the October 1993 initial public offering at \$1.50 per share
- ⁽⁶⁾ Four parameters include proven reserves, production, cash flow and earnings

Zargon is committed to providing substantial, sustainable and profitable growth as measured by corporate recycle ratios and the return on book equity. Throughout its eleven year history, Zargon has delivered an average rate of return on book equity in excess of 16 percent per year, and an average proven historical corporate recycle ratio of 2.0 times.

CORPORATE PERFORMANCE

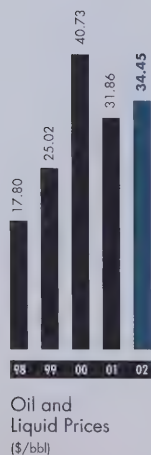
	2002	2001	2000	1999	1998	Three Year Average (2000-2002)	Five Year Average (1998-2002)	Eleven Year Average (1992-2002)
Corporate recycle ratio ⁽¹⁾	1.4	1.9	3.2	2.0	1.4	2.0	2.0	2.0
Return on equity (%) ⁽²⁾	13.6	23.4	30.0	13.8	4.8	20.4	17.7	16.3

Notes

- ⁽¹⁾ Corporate recycle ratio is defined as the corporate cash flow including allowances for taxes, interest charges and general and administrative costs on a barrel of oil equivalent production basis divided by proven finding and development costs
- ⁽²⁾ Return on equity is defined as the net after tax annual earnings divided by the year average shareholders' equity. Multi-year averages are dollar weighted

Zargon reported solid operational results in 2002 with gains in production and reserves, but the impact of substantially lower average natural gas prices resulted in lower comparative financial results.

MANAGEMENT'S DISCUSSION & ANALYSIS



HIGHLIGHTS

For 2002, revenue increased slightly, cash flow decreased marginally and earnings were down 19 percent from 2001 levels. Net capital expenditures decreased 36 percent, primarily because 2001 capital expenditures were expanded by the corporate acquisition of Herc Energy Corp.

(\$ million, except per share amounts)	2002	2001	Percent Change
Production revenue	65.54	63.80	3
Cash flow from operations	32.12	32.67	(2)
Per diluted share (\$)	1.81	2.03	(11)
Earnings	10.68	13.14	(19)
Per diluted share (\$)	0.60	0.82	(27)
Net capital expenditures	35.55	55.18	(36)

DETAILED FINANCIAL ANALYSIS

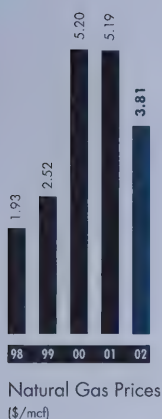
PRODUCTION REVENUE

Zargon derives its revenue from the production and sale of crude oil, natural gas liquids and natural gas. Oil (inclusive of natural gas liquids) and natural gas revenue exclusive of hedges increased three percent to \$65.54 million in 2002 from \$63.80 million in 2001 and \$53.31 million in 2000. Production volumes in 2002 increased 14 percent from the prior year and were the major contributor to higher revenue. The average price of oil and liquids received by Zargon rose to \$34.45 per barrel in 2002, up eight percent from 2001, but the average field price of natural gas fell 27 percent to \$3.81 per thousand cubic feet from the 2001 average that included very high first quarter 2001 natural gas prices.

Production revenue in 2002 was allocated 43 percent to the sale of natural gas and 57 percent to the sale of oil and liquids. Natural gas revenue allocations had been trending higher from a 31 percent weighting in 1998 to 55 percent in 2001. The 2002 reversal of this trend was caused by relatively low natural gas prices during the first nine months of 2002, and from the effect of additional oil volumes from the July 2001 oil weighted acquisition of Herc Oil Corp. The current much higher natural gas prices, coupled with Zargon's recent growth in natural gas volumes, are expected to result in a higher natural gas revenue allocation in 2003.

CRUDE OIL PRICING

Zargon's field crude oil and liquid prices are negatively adjusted for transportation charges and oil quality differentials from an Edmonton light sweet price that varies with world commodity prices. In 2002, Zargon's average oil and liquid field price, exclusive of price hedges, rose eight percent to \$34.45 per barrel from



\$31.86 per barrel in 2001. The field price differential for Zargon's average blended 30 degree API crude stream was \$5.49 per barrel less than the 2002 Edmonton reference crude price, which compares to the 2001 differential of \$7.32 per barrel (\$3.60 per barrel in 2000). The improved 2002 price differential is attributed to the narrowing of the Canadian market's medium gravity crude differentials, as Zargon's crude quality has remained relatively consistent during the last two years.

NATURAL GAS PRICING

During 2002, Zargon's field natural gas price exclusive of price hedges stayed relatively low throughout the first three quarters at an average of \$3.28 per thousand cubic feet. Prices strengthened significantly in the fourth quarter as supply shortfalls became apparent to the market and brought the average for the year up to \$3.81 per thousand cubic feet compared to \$5.19 in 2001 and \$5.20 in 2000. Approximately 41 percent of Zargon's 2002 gas production was sold under aggregator contracts pursuant to long-term contracts with Mirant Energy Ltd. (Jarrow – 33 percent) and ProGas Limited (Hamilton Lake – eight percent). The remainder of Zargon's gas production was sold by spot sale contracts and received Alberta index prices. As Zargon develops significant new gas reserves outside of the original Jarrow and Hamilton Lake aggregator contract areas, it is anticipated that the aggregator share of total production will continue to decline.

HEDGING ACTIVITIES

Crude oil and natural gas prices again moved in large ranges in 2002 and our hedging program functioned by mitigating the effects on revenue of price peaks and valleys. During the first three quarters, natural gas prices were weak and below expectations and hedging activities produced a net gain in revenue of \$1.38 million. Both natural gas and oil prices began to climb in September and the overall hedge gain in revenue for the 2002 year was reduced to \$0.67 million. This compares with hedge losses of \$0.57 million in 2001 and \$2.73 million in 2000. A similar level of risk management was employed in all three years but price swings varied widely as did the degree of predictability. As a matter of strategic policy, Zargon maintains 20 to 30 percent of net production volumes (after royalty deductions) hedged for up to 18 months in advance. Where commercially feasible, Zargon minimizes the use of fixed price swaps, replacing them with a combination of puts and costless collars so as to preserve the ability to benefit from unexpected increases in price.

During the year, crude oil and currency hedges resulted in a \$0.35 million reduction of 2002 oil and liquid revenues, which is equivalent to a \$0.33 per barrel charge against the year's total oil and liquid production. Natural gas hedges added to Zargon's 2002 revenues by \$1.02 million, equivalent to a \$0.14 per thousand cubic feet gain on the year's total natural gas production.

ROYALTIES

Royalties include payments made to the Crown, freehold owners and third parties. Reported royalties include credits received through the Alberta Royalty Tax Credit (ARTC) program, the cost of the Saskatchewan Resource Surcharge (SRC) and the cost of the North Dakota state and county taxes. During 2002, total royalties were \$13.51 million, down five percent from \$14.22 million in 2001. Royalties as a percentage of gross revenue (before hedging adjustments) were 20.6 percent in 2002 compared to 22.3 percent in 2001 and 20.1 percent in 2000. On a commodity basis, oil royalties averaged 19.9 percent (before hedging), which was a slight increase from the

previous year's average of 19.8 percent. Natural gas royalties averaged 21.5 percent, down from 24.3 percent in 2001. The lower natural gas royalty rate is a consequence of the natural gas cost allowance being a larger relative deduction against the Crown royalty expense, during the 2002 lower natural gas price year.

During the year, 53 percent of the total royalties were paid to provincial governments with the remainder paid to freehold owners and other third parties. Royalties payable to the Province of Alberta on qualifying properties are reduced through the ARTC program. Zargon received a \$0.32 million ARTC rebate in 2002 compared to a \$0.50 million rebate in 2001. Due to higher Saskatchewan oil revenues the SRC charges increased to \$0.52 million in 2002 from \$0.34 million in 2001 and \$0.30 million in 2000. North Dakota state and county taxes increased to \$0.52 million Cdn. in 2002 from the part year total of \$0.20 million in 2001.

PRODUCTION EXPENSES

Zargon's production expenses increased 31 percent to \$15.65 million in 2002. On a unit of production basis, expenses increased 15 percent to \$6.75 per barrel of equivalent from \$5.89 per barrel of equivalent in 2001 (\$5.68 per barrel of equivalent in 2000).

Production expenses for natural gas increased 17 percent to \$0.69 per thousand cubic feet, up from \$0.59 per thousand cubic feet in both 2000 and 2001. The increased costs reflected a full year of additional Jarrow compression charges and higher costs from the acquired Hadrian natural gas properties. This trend to higher natural gas production costs is expected to be reversed in 2003 as substantial new West Central Alberta lower-cost higher-rate volumes are being added through Zargon operated facilities.

In 2002 oil production expenses climbed 10 percent to \$9.72 per barrel from \$8.85 per barrel in 2001 and \$8.69 per barrel in 2000. The acquisition of Herc Oil Corp. in mid-2001 increased oil production 42 percent by adding largely long-life, low-decline exploitable properties with relatively high production costs. This was followed in mid-2002 by the acquisition of another higher-cost exploitable oil property at Modeste Creek in West Central Alberta. The combined effect of these acquisitions was to increase Zargon's average oil production cost.

The reversal of these increasing trends in production costs is a key focus for Zargon. In the fourth quarter of 2002, the first of a series of proposed dispositions of high-cost, non-core properties was concluded, taking advantage of the current robust property markets. Other field initiatives are underway to control and improve production costs, but material improvements in our cost structure will require the disposition of the higher cost component of our property base.

OPERATING NETBACKS

The average oil price received after hedges in 2002 was \$34.12 per barrel, eight percent higher than the \$31.53 per barrel in 2001 while the average natural gas price received after hedges in 2002 was \$3.95 per thousand cubic feet, 23 percent lower than \$5.15 per thousand cubic feet in 2001. During 2002, Zargon's oil netbacks increased seven percent to \$17.54 per barrel from \$16.37 per barrel in 2001 (\$20.92 per barrel in 2000) while natural gas netbacks declined 26 percent to \$2.44 per thousand cubic feet from \$3.30 per thousand cubic feet in 2001 (\$3.43 per thousand cubic feet in 2000). On an equivalent basis, 2002 operating netbacks fell 13 percent to \$15.99 per barrel of equivalent from \$18.29 per barrel of equivalent in 2001 (\$20.62 per barrel of equivalent in 2000).

OPERATING NETBACKS

	2002		2001	
	Oil & Liquids	Natural Gas	Oil & Liquids	Natural Gas
	(\$/bbl)	(\$/mcf)	(\$/bbl)	(\$/mcf)
Revenues (adjusted for hedges)	34.12	3.95	31.53	5.15
Royalties (net of ARTC and SRC)	(6.86)	(0.82)	(6.31)	(1.26)
Production costs	(9.72)	(0.69)	(8.85)	(0.59)
Operating netbacks	17.54	2.44	16.37	3.30

GENERAL AND ADMINISTRATIVE EXPENSES

Gross general and administration costs increased 12 percent in 2002 to \$5.06 million from \$4.50 million in 2001 reflecting increased technical and professional inputs from our staff. On a unit of production basis, general and administrative costs decreased two percent to \$1.49 per barrel of equivalent. Zargon's growth strategy is based on the exploitation of oil properties with high operational, reservoir and engineering requirements and through the exploration/exploitation of gas properties using an intense geophysical and geological focus. Each of these initiatives requires substantial inputs from professional and technical staff. Salaries and related benefits for all exploration staff are included in general and administrative expenses. Since 1995, Zargon has maintained a policy of not capitalizing any portion of its general and administrative costs.

GENERAL AND ADMINISTRATIVE EXPENSES

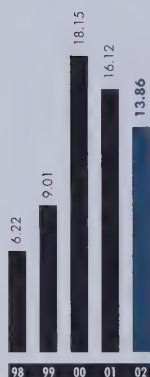
(\$ million, except as noted)	2002	2001	2000
Gross general and administrative expense	5.06	4.50	3.53
Overhead recoveries	(1.61)	(1.42)	(1.34)
Net general and administrative expense	3.45	3.08	2.19
Net expense after recoveries (\$/boe)	1.49	1.52	1.44
Number of employees at yearend	31	30	24

INTEREST EXPENSE

Zargon's primary borrowings are through its bank line of credit. Despite expanded debt levels in 2002, unprecedented low short-term interest rates kept interest charges down to \$1.10 million in 2002, compared to \$0.96 million in 2001 and \$1.27 million in 2000. Zargon's effective interest rate was 4.1 percent on an average bank debt of \$26.72 million in 2002 compared to 4.9 percent on an average bank debt of \$19.50 million in 2001 and a 7.1 percent effective interest rate on an average bank debt of \$18.00 million in 2000. At yearend 2002 Zargon's bank debt including working capital totalled \$28.74 million, up four percent from \$27.65 million at December 31, 2001 and substantially higher than the \$18.42 million reported at December 31, 2000.

CAPITAL AND CURRENT INCOME TAX

Zargon did not pay current income taxes in 2002, but remitted \$0.38 million of federal and provincial capital taxes compared to the \$0.36 million remitted in 2001. Zargon reorganized its operations into a partnership structure effective July 10, 2001 and acquired significant excess tax pools with both the 2001 Herc Oil Corp. and 2002 Hadrian Energy Corp. acquisitions. These transactions helped increase the 2002 year-end tax pools to approximately \$87 million compared to the 2001 year-end balance of \$73 million. It is expected that Zargon will have sufficient tax pools to shelter most or all of budgeted 2003 taxable income.



Corporate Cash Flow Netback (\$/boe)

CORPORATE CASH FLOW NETBACKS

Lower gas prices in the first three quarters of 2002 were the primary reason for lower operating 2002 netbacks as compared to the previous years. Corporate cash flow netbacks, defined as operating netbacks less general and administrative costs, financing charges and cash taxes, were also lower in 2002 averaging \$13.86 per barrel of equivalent, 14 percent below the 2001 netback of \$16.12 per barrel of equivalent (\$18.15 per barrel of equivalent in 2000).

CORPORATE NETBACKS

(\$/boe)	2002	2001	2000
Revenue	28.28	31.48	35.17
Hedging	0.29	(0.29)	(1.80)
Royalties	(5.83)	(7.01)	(7.07)
Production costs	(6.75)	(5.89)	(5.68)
Operating netbacks	15.99	18.29	20.62
General and administrative	(1.49)	(1.52)	(1.44)
Financing charges	(0.47)	(0.47)	(0.84)
Capital and current income taxes	(0.17)	(0.18)	(0.19)
Corporate cash flow netbacks	13.86	16.12	18.15
Depletion and depreciation	(5.84)	(5.22)	(4.49)
Site restoration and reclamation	(0.55)	(0.52)	(0.48)
Foreign exchange	(0.03)	(0.05)	—
Future income taxes	(2.83)	(3.85)	(5.75)
Net earnings	4.61	6.48	7.43

CASH FLOW FROM OPERATIONS

In 2002, a 14 percent gain in production volumes was offset by a 14 percent reduction in corporate cash flow netbacks, with the net result that 2002 cash flow from operations of \$32.12 million declined two percent from the 2001 levels of \$32.67 million (\$27.50 million in 2000). The corresponding cash flow per diluted share was \$1.81 in 2002, 11 percent below \$2.03 in 2001 and compares to \$1.86 in 2000. The per share statistics reflected a six percent increase in outstanding shares to 17.64 million at December 31, 2002 from 16.67 million at December 31, 2001.

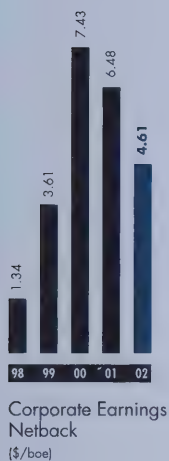


Cash Flow from Operations (\$ million)

DEPLETION AND DEPRECIATION

In 2002, Zargon's depletion and depreciation provision increased 12 percent to \$5.84 per barrel of equivalent, up from \$5.22 per barrel of equivalent in 2001 and \$4.49 per barrel of equivalent in 2000. Depletion, depreciation and site restoration charges calculated on a unit of production method are based on total proven reserves with a conversion of six thousand cubic feet of natural gas being equivalent to one barrel of oil. The 2002 depletion calculation includes \$6.04 million of future capital expenditures to develop the Company's reserves but excludes \$11.14 million of unproven properties relating to undeveloped land. Zargon's historically low unit depletion and depreciation charges increased in 2001 and 2002, and reflects the industry-wide trend, also experienced by Zargon, to higher finding and development costs.

Zargon's corporate depletion and depreciation provision increased 28 percent to \$13.54 million in 2002 compared to \$10.58 million in 2001 and \$6.80 million in 2000. The higher charges reflected both increased production volumes and the higher per unit charges referred to above.



SITE RESTORATION AND RECLAMATION

Zargon provided for \$1.27 million of site restoration and reclamation charges in 2002 compared to \$1.05 million in 2001 and a \$0.72 million provision in 2000. This charge of \$0.55 per barrel of equivalent is six percent higher than the \$0.52 and 15 percent higher than the \$0.48 per barrel of equivalent charges booked in 2001 and 2000 respectively. Higher 2002 charges reflected the increased abandonment liabilities acquired in the Herc and Hadrian acquisitions. Zargon accrues the estimated future restoration and reclamation charges on a unit of production basis assuming a \$25,000 net after salvage abandonment charge for each net working interest well.

FUTURE INCOME TAXES

Zargon's 2002 future tax expense decreased 16 percent to \$6.55 million from \$7.81 million in 2001 (\$8.71 million in 2000). On a unit of production basis, future income taxes were \$2.83 per barrel of equivalent in 2002, a decrease of 26 percent from the prior year's future income taxes of \$3.85 per barrel of equivalent (\$5.75 per barrel of equivalent in 2000). The 2002 effective tax rate (current and future) increased marginally to 39 percent from 38 percent in 2001 (44 percent in 2000).

NET EARNINGS

Zargon's 2002 net earnings were \$10.68 million, down 19 percent from \$13.14 million in 2001 and compare to \$11.26 million recorded in 2000. On a per diluted share basis, 2002 net earnings decreased 27 percent to \$0.60 from \$0.82 in 2001 and were \$0.76 in 2000. The reduction in per share earnings from 2001 resulted from a combination of lower average commodity prices, higher depletion and depreciation charges, and additional shares outstanding.

On a unit of production basis, the 2002 net earnings were \$4.61 per barrel of equivalent compared to \$6.48 per barrel of equivalent in 2001 and \$7.43 per barrel of equivalent in 2000. Reflecting lower natural gas prices and higher depletion and depreciation charges, the 2002 net earnings represented 33 percent of cash flow, down sharply from 40 percent of cash flow in 2001 and 41 percent in 2000.

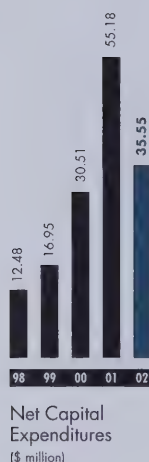
RETURN ON EQUITY

Zargon's pre-tax return on shareholders' equity in 2002 remained high at 22 percent, although down from 38 percent in the previous year (54 percent in 2000). The after-tax return on shareholders' equity in 2002 declined to 14 percent from 23 percent in the prior year (30 percent in 2000). Zargon's after tax rates of return on equity have averaged 20 percent over the past three years and 16 percent over the Company's eleven year corporate history.

CAPITAL EXPENDITURES

Net capital expenditures in 2002 of \$35.55 million decreased sharply from \$55.18 million in 2001, which included the relatively large Herc corporate acquisition and compares to \$30.51 million in 2000. During the year, Zargon supported an aggressive land acquisition program and active exploration activities, spending \$2.47 million or seven percent of the net capital expenditures on geological and geophysical activities. Total undeveloped land expenditures were \$4.46 million and were highlighted by \$4.20 million of Crown land purchases at an average cost of \$58 per acre. Drilling, completions and workover field activities in 2002 were focused on gas exploration in East and West Central Alberta and totalled \$12.49 million, 35 percent of





the year's capital program. A further \$4.48 million was expended on production equipment and facilities in 2002 as Zargon tied-in new gas wells from successful drilling programs.

On June 17, 2002 Zargon acquired all of the outstanding shares of Hadrian Energy Corp., a private company, for \$9.60 million, including \$4.75 million cash and the issuance of 542 thousand common shares valued at \$8.75 per share. The corporate acquisition was accounted for by the purchase method, with \$7.39 million assigned to the property and equipment accounts. During the year, Zargon made additional property acquisitions of \$7.39 million and dispositions of \$3.13 million for a net amount of property acquisitions of \$4.26 million. The Hadrian acquisition provided Zargon with new gas exploration opportunities while the property acquisitions generally related to oil exploitation projects. The dispositions were opportunity-driven and consisted of non-core, non-operated, higher-cost assets sold in the fourth quarter during a period of higher oil and natural gas commodity prices. In 2003, Zargon is projecting to spend \$45 million of capital expenditures.

CAPITAL EXPENDITURES

(\$ million)	2002	2001	2000
Undeveloped land	4.46	5.08	2.93
Geological and geophysical (seismic)	2.47	3.80	3.06
Drilling and completion of wells	12.49	17.44	11.28
Well equipment and facilities	4.48	4.87	3.89
Exploration and development	23.90	31.19	21.16
Property acquisitions	7.39	4.83	10.09
Property dispositions	(3.13)	(4.23)	(0.74)
Net property acquisitions	4.26	0.60	9.35
Corporate acquisitions assigned to property and equipment	7.39	23.39	-
Total net capital expenditures	35.55	55.18	30.51

LIQUIDITY AND CAPITAL RESOURCES

Zargon relies on three sources of funding to support its capital expenditure programs:

- Internally generated cash flow provides the basic level of funding for the Company's annual capital expenditures program.
- Debt may be utilized to expand capital programs when it is deemed appropriate. The Company has followed and intends to maintain a conservative debt policy.
- New equity, if available and if on favourable terms, will be utilized to expand further capital programs. Conversely, on occasions when Zargon's equity may be valued by the stock market at levels perceived to be at a substantial discount to the underlying net asset value, the Corporation will consider the repurchase of its shares through an issuer bid.

In calendar 2002, Zargon's capital program was funded 90 percent from cash flow from operations, with a very small increase of \$1.14 million in bank debt and the balance by equity issued in the Hadrian transaction.

Pursuant to the Company's stock option plan, Zargon issued 429 thousand shares for \$1.26 million to employees and directors of the Company in 2002, at an average exercise price of \$2.94 per share. In the prior year, 374 thousand shares were issued pursuant to the plan at an average exercise price cost of \$2.37 per share.

CAPITAL SOURCES

(\$ million)	2002	2001	2000
Cash flow from operations	32.12	32.67	27.50
Changes in working capital	(3.58)	0.39	1.98
Bank indebtedness	1.14	8.23	1.79
Issuance (buyback) of common shares	5.87	13.89	(0.76)
Total capital sources	35.55	55.18	30.51

CASH FLOW

It is anticipated that the majority, if not all of Zargon's 2003 capital budget will be financed through the reinvestment of the Company's cash flow from operations. Cash flow is partially influenced by factors that the Company cannot control such as commodity prices, the US/Canadian dollar exchange rates and interest rates. Zargon's 2003 sensitivity to moderate fluctuations in these key business parameters is shown in the accompanying table.

CASH FLOW SENSITIVITY SUMMARY

	Change in 2003 Cash Flow	
	(\$ million)	(\$/share)
Change of \$1.00 US/bbl in the price of WTI oil	1.11	0.07
Change in oil production of 100 bbl/d	0.41	0.03
Change of \$0.10 US/mcf in the price of NYMEX natural gas	0.71	0.05
Change in natural gas production of 1 mmcf/d	0.59	0.04
Change in \$0.01 in the \$US/\$Cdn exchange rate	0.31	0.02

BANK INDEBTEDNESS

The Company has authorized lines of credit totaling approximately \$57 million: \$50 million with a Canadian bank and \$4.3 million US with an American bank. At December 31, 2002, total debt outstanding including working capital was \$28.74 million, comparable to the prior year-end amount of \$27.65 million. Effective January 1, 2002 the Company adopted the new CICA recommendations that treat revolving demand bank debt as a current liability.

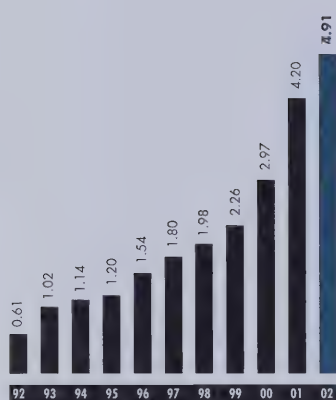
Zargon's combined debt and working capital deficiency of \$28.74 million at December 31, 2002 was equivalent to 89 percent of the 2002 cash flow from operations of \$32.12 million. At December 31, 2001 the combined debt and working capital deficiency was \$27.65 million, equivalent to 85 percent of 2001 cash flow from operations.

EQUITY

On June 17, 2002 Zargon issued 542 thousand common shares as partial consideration for Hadrian Energy Corp. The shares issued were valued at \$8.75 per share.

At year-end 2002, Zargon had 17.64 million shares outstanding. Including the 1.22 million options outstanding (0.75 million vested at December 31, 2002) under the Company stock option plan; Zargon's fully diluted year-end balance of shares outstanding is 18.86 million.

During 2002, 6.33 million Zargon shares traded on The Toronto Stock Exchange with a high of \$9.50 per share, a low of \$7.00 per share and a close of \$9.00 per share. The 2002 trading statistics show a



Shareholders' Equity
(\$/share)

15 percent year-over-year decrease in trading volume, and a 25 percent increase in the closing stock price. Zargon's market capitalization at year-end 2002 was approximately \$160 million.

SEGMENTED GEOGRAPHIC INFORMATION

In calendar 2002, Zargon received approximately 11 percent of its combined oil and natural gas revenue from properties located in the US states of North Dakota and Montana.

BUSINESS RISKS AND OUTLOOK

BUSINESS RISKS

Zargon's external business risks arise from the uncertainty of crude oil and natural gas pricing, the uncertainty of interest and exchange rates, environmental and safety issues, and financial and liquidity considerations. Additional risk arises from the production performance of existing properties and the uncertain results from capital expenditure programs.

Zargon attempts to minimize pricing and currency exchange uncertainty with a risk management program that encompasses a variety of financial instruments. These include forward sales of crude oil and natural gas production, put options on both oil and gas, costless collars (in which some potential high price gain is given up in return for potential low price support) and US dollar currency hedges in different forms for up to 30 percent of its net oil and natural gas volumes. In general the Company seeks to use strategies that allow minimum price expectations to be met while preserving most of the Company's exposure to higher prices. Environmental and safety risks are mitigated through compliance with provincial and federal environmental and safety regulations, by maintaining adequate insurance, and by adopting appropriate emergency response and employee safety procedures.

Financial and liquidity risks are reduced by limiting debt financing to conservative self-imposed debt to cash flow guidelines. Zargon actively manages the risks of its capital programs by concentrating drilling and subsequent development activities in areas where it has demonstrated proven technical capabilities. Finally, Zargon's capital budget is allocated so as to limit capital exposure to any one project or concept to a manageable level.

CORPORATE OUTLOOK

Zargon remains confident of its ability to maintain its record of consistent and sustainable, profitable growth. For calendar 2003, Zargon has budgeted \$45 million of capital expenditures allocated to gas exploration, oil exploitation and property acquisition opportunities.

SELECTED QUARTERLY INFORMATION

(\$ million, except per share amounts)

	2002				2001			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Production revenue	20.67	16.65	15.50	12.73	11.18	14.67	16.90	21.04
Cash flow from operations	10.71	7.75	7.47	6.19	5.81	7.66	8.59	10.61
Per diluted share (\$)	0.59	0.43	0.42	0.36	0.34	0.44	0.57	0.71
Earnings	4.28	2.27	2.55	1.58	1.77	2.60	3.49	5.28
Per diluted share (\$)	0.24	0.13	0.14	0.09	0.10	0.15	0.22	0.36
Total assets	153.7	146.0	137.8	129.0	127.9	119.1	108.3	90.9
Bank indebtedness	25.28	28.71	28.00	25.26	24.14	19.27	13.19	10.09

MANAGEMENT'S
REPORT

The consolidated financial statements of Zargon Oil & Gas Ltd. were prepared by management in accordance with Canadian generally accepted accounting principles. The financial and operating information presented in this annual report is consistent with that shown in the consolidated financial statements.

Management has designed and maintains a system of internal controls to provide reasonable assurance that all assets are safeguarded and to facilitate the preparation of financial statements for reporting purposes. Timely release of financial information sometimes necessitates the use of estimates when transactions affecting the current accounting period cannot be finalized until future periods. Such estimates are based on careful judgements made by management.

External auditors appointed by the shareholders have conducted an independent examination of the Corporation's accounting records in order to express their opinion on the consolidated financial statements.

The Board of Directors is responsible for ensuring that management fulfils its responsibilities for financial reporting and internal control. The Board exercises this responsibility through its Audit Committee. The Audit Committee, which consists of non-management directors has met with the external auditors and management in order to determine that management has fulfilled its responsibilities in the preparation of the consolidated financial statements. The Audit Committee has reported its findings to the Board of Directors who have approved the consolidated financial statements.



J.O. McCutcheon
Chairman

Calgary, Canada
February 28, 2003



C.H. Hansen
President and Chief Executive Officer

AUDITORS'
REPORT

TO THE SHAREHOLDERS OF ZARGON OIL & GAS LTD.

We have audited the consolidated balance sheets of Zargon Oil & Gas Ltd. as at December 31, 2002 and 2001 and the consolidated statements of income and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2002 and 2001 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.



Chartered Accountants

Calgary, Canada
February 28, 2003

CONSOLIDATED
BALANCE SHEETS

As at December 31 (\$ thousand)

2002

2001

ASSETS [note 4]

Current

Cash	-	201
Accounts receivable	11,942	7,990
Prepaid expenses and deposits	712	741
	12,654	8,932
Property and equipment [note 3]	141,006	118,994
	153,660	127,926

LIABILITIES

Current

Bank indebtedness [note 4]	25,279	-
Accounts payable and accrued liabilities	16,118	12,440
	41,397	12,440
Long-term debt [note 4]	-	24,137
Future site restoration	4,746	3,141
Future income taxes [note 6]	20,922	18,223
	67,065	57,941

Commitments [note 8]

SHAREHOLDERS' EQUITY

Share capital [note 5]	40,997	35,066
Retained earnings	45,598	34,919
	86,595	69,985
	153,660	127,926

See accompanying notes

On behalf of the Board:



J.O. McCutcheon
Director



C.H. Hansen
Director

CONSOLIDATED
STATEMENTS OF
INCOME AND
RETAINED
EARNINGS

For the years ended December 31 (\$ thousand, except for per share amounts)

	2002	2001
Income		
Oil and gas sales	65,538	63,795
Hedging gain (loss) [note 8]	669	(573)
Royalties (net of Alberta Royalty Tax Credit)	(13,508)	(14,222)
	52,699	49,000
Expenses		
Production	15,649	11,933
General and administrative	3,455	3,083
Interest	1,100	957
Foreign exchange	86	107
Site restoration	1,268	1,045
Depletion and depreciation	13,536	10,576
	35,094	27,701
Income before income taxes	17,605	21,299
Income taxes [note 6]		
Future	6,548	7,806
Current	378	358
	6,926	8,164
Net income for the year	10,679	13,135
Retained earnings, beginning of year	34,919	21,855
Repurchase of common shares [note 5]	-	(71)
Retained earnings, end of year	45,598	34,919
Earnings per common share [note 7]		
Basic	0.62	0.84
Diluted	0.60	0.82

See accompanying notes

CONSOLIDATED
STATEMENTS OF
CASH FLOWS

For the years ended December 31 (\$ thousand, except for per share amounts)	2002	2001
Operating activities		
Net income for the year	10,679	13,135
Add non-cash items:		
Depletion and depreciation	13,536	10,576
Site restoration	1,268	1,045
Foreign exchange	86	107
Future income taxes	6,543	7,806
Cash flow from operations	32,117	32,669
Change in non-cash working capital	(2,587)	(1,189)
	29,530	31,480
Financing activities		
Bank indebtedness and long-term debt	1,142	8,235
Exercise of stock options	1,262	886
Issuance of common shares	-	13,106
Repurchase of common shares	-	(105)
	2,404	22,122
Investing activities		
Acquisition of property and equipment	(31,296)	(36,014)
Disposal of property and equipment	3,134	4,230
Corporate acquisitions (cash portion) [note 2]	(4,875)	(19,831)
Site restoration expenditures	(423)	(340)
Change in non-cash working capital	1,325	(1,605)
	(32,135)	(53,560)
Increase (decrease) in cash	(201)	42
Cash, beginning of year	201	159
Cash, end of year	-	201
Cash interest paid	1,150	956
Cash taxes paid	378	218
Cash flow from operations per share [note 7]		
Basic	1.86	2.10
Diluted	1.81	2.03
See accompanying notes		

NOTES TO
CONSOLIDATED
FINANCIAL
STATEMENTS

For the years ended
December 31, 2002 and 2001

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business

Zargon Oil & Gas Ltd. ("Zargon" or the "Corporation") is a public company that trades on the Toronto Stock Exchange, and is incorporated under the Business Corporations Act (Alberta). The Corporation is engaged in the exploration, development and production of oil and gas in Canada and the United States.

Consolidation

These consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. The consolidated financial statements include the accounts of Zargon Oil & Gas Ltd., all subsidiaries and a partnership.

All subsidiaries and a partnership are directly or indirectly wholly owned and their operations are fully reflected in the consolidated financial statements.

Joint Operations

The majority of the oil and gas operations of the Corporation are conducted jointly with others and accordingly these financial statements reflect only the proportionate interests of the Corporation in such activities.

Property and Equipment

The Corporation follows the full cost method of accounting for its oil and gas operations in accordance with the guideline issued by the Canadian Institute of Chartered Accountants whereby all costs relating to the acquisition, exploration and development of petroleum and natural gas reserves are capitalized. Such costs include land acquisition costs, annual carrying charges of non-producing properties, geological and geophysical costs, and costs of drilling and equipping both productive and non-productive wells. General and administrative costs related to these activities are not capitalized.

Depletion and depreciation of capitalized costs is computed using the unit-of-production method based on the estimated proven reserves of oil and gas determined by independent consultants. Reserves are converted to common units on the basis that six thousand cubic feet of gas is equivalent to one barrel of oil and liquids.

The Corporation applies a ceiling test to capitalized costs on a quarterly basis to ensure that such costs do not exceed the estimated undiscounted future net revenues from production of gross proven reserves using quarter end market prices, plus the cost of undeveloped properties, net of impairment, less amounts associated with future production costs, general and administrative, financing, site restoration, and income tax costs.

Proceeds on the disposal of petroleum and natural gas properties are applied against capitalized costs, with gains or losses not ordinarily recognized, unless such a disposal would result in a change in the depletion rate of 20% or more.

Depreciation of office equipment is provided using the declining balance method at an annual rate of 20%.

Future Site Restoration and Abandonment Costs

Estimated future site restoration and abandonment costs, including the removal of production facilities at the end of their useful lives, and net of salvage values, are provided for using the unit-of-production method. This estimate is based on current costs, existing legislation and industry standards. The annual charge is accounted for as an expense and the accumulated provision is reflected as a deferred liability. Actual site restoration costs are deducted from the accumulated provision in the year incurred.

Financial Instruments

Financial instruments of the Corporation consist of cash, accounts receivable, accounts payable and accrued liabilities, and bank indebtedness. As at December 31, 2002 and 2001, there are no significant differences between the carrying values of these amounts and their estimated market values.

Derivative Financial Instruments

Derivative financial instruments are utilized to reduce commodity price risk for the Corporation's production of oil and natural gas. The base prices for the commodities are sometimes denominated in United States dollars and the Corporation may also use such financial instruments to reduce the related foreign currency risk. Financial instruments may also be used from time to time to reduce interest rate risk on outstanding debt. The Corporation does not enter into financial instruments for trading or speculative purposes.

The Corporation follows a policy of using hedge instruments such as fixed price swaps, forward sales, options and costless collars. The objective is to partially offset or mitigate the wide price swings commonly encountered in these commodities. The Corporation's policy is to designate each derivative financial instrument employed as a hedge of a specific portion of projected production over the term of the instrument. The instruments employed may be denominated in United States or Canadian dollars. The Corporation believes the derivative financial instruments used are effective as hedges over their term. In times of particular price volatility such as the current year, the Corporation employs options and costless collars as a preference if their cost is commercially acceptable so that much of the benefit of unforeseen high prices will continue to be available.

In the case of forward sales, the instrument can sometimes be satisfied by physical delivery. In all other cases the instrument is satisfied by payments or charges calculated by referring published prices to the agreed reference price in the terms and manner set out in the contract and paid or received monthly. In the case of physical delivery, the payment is part of the normal revenue stream and all other payments or charges are accounted for monthly as adjustments to revenue received.

Interest rate swap agreements are used from time to time to manage the floating interest rate on the Corporation's revolving bank debt. Such agreements involve the periodic exchange of payments without the exchange of the notional principal amount on which the payments are based.

Foreign currency swap agreements are used from time to time to manage the risk inherent in producing commodities whose price is based directly or indirectly on United States dollars, using a notional principal equal to the projected monthly revenue from their sale. Payments or charges are calculated and paid according to the terms of the agreement, usually with monthly settlement. Foreign currency swap agreements are designated as hedges of revenue that is received in Canadian dollars but whose amount is determined in foreign currency.

Gains or losses from these contracts, other than forward sales settled by physical delivery, are recognized as hedging gains or losses when realized.

Income Taxes

The Corporation follows the liability method of tax allocation in accounting for income taxes. Under this method, the Corporation records future income taxes for the effect of any differences between the accounting and income tax basis of an asset or liability (temporary differences). Future income tax assets and liabilities are measured using income tax rates expected to apply in the years in which temporary differences are expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in tax rates is recognized in net income in the period in which the change is substantially enacted.

Foreign Currency Translation

The Corporation uses the temporal method of foreign currency translation whereby the monetary assets and liabilities recorded in a foreign currency are translated into Canadian dollars at year-end exchange rates and non-monetary assets and liabilities at the exchange rates prevailing when the assets were acquired or liability incurred. Revenues and expenses are translated at the average rate of exchange for the year. Gains and losses on translation are included in the consolidated statement of income.

Stock Options and Stock Based Compensation

The Corporation has a stock option plan available to employees and directors with grants under the Plan approved from time to time by the Board of Directors. Under the Plan, the Corporation is authorized to issue options to purchase, in aggregate, up to 10% of the issued and outstanding common shares. The options vest after one, two or three years and expire not more than five years from the date of grant. Each option can be exercised for one common share of the Corporation.

Effective January 1, 2002, the Corporation adopted the new CICA 3870 standard for reporting stock based compensation. As permitted by the CICA 3870, the Corporation has applied this change prospectively for all new awards granted after January 1, 2002. The Corporation has chosen to recognize no compensation when stock options are granted to employees and directors under the stock option plan that has no cash settlement features. The fair value of stock options are determined using the Black-Scholes option pricing model.

Per Share Amounts

The Corporation follows the treasury stock method for the computation and disclosure of diluted per share amounts. Under this method, the diluted weighted average number of common shares is calculated assuming the proceeds from the exercise of dilutive options are used to purchase common shares at the average market price.

Measurement Uncertainty

The amounts recorded for depletion and depreciation of property and equipment and the provision for future site restoration are based on estimates. The ceiling test calculation is based on estimates of proven reserves, production rates, oil and natural gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the impact on the financial statements of changes in such estimates in future periods could be material.

2. ACQUISITIONS

On June 17, 2002, the Corporation acquired all of the outstanding shares of Hadrian Energy Corp. ("Hadrian"), a private oil and gas company, for consideration of \$9.60 million. Consideration consisted of \$4.745 million cash and the issuance of 542,340 Zargon common shares valued at \$8.75 per share. Costs of \$0.13 million were incurred to effect the transaction and were charged to share capital. The acquisition was accounted for by the purchase method as follows:

(\$ thousand)	2002
Working capital	(816)
Property and equipment	7,386
Future tax asset	3,792
Future site restoration	(760)
Total consideration	9,602

On July 10, 2001, the Corporation acquired all of the outstanding shares of Herc Oil Corp. ("Herc"), a private oil and gas company, for cash consideration of \$19.83 million. The acquisition was accounted for by the purchase method as follows:

(\$ thousand)	2001
Working capital	1,972
Property and equipment	23,392
Future tax asset	993
Long-term debt	(5,696)
Future site restoration	(830)
Cash consideration	19,831

3. PROPERTY AND EQUIPMENT

(\$ thousand)

	2002		
	Cost	Accumulated Depletion and Depreciation	Net Book Value
Petroleum and natural gas rights	153,877	39,104	114,773
Production equipment and facilities	35,499	9,621	25,878
Office equipment	891	536	355
	190,267	49,261	141,006

(\$ thousand)

	2001		
	Cost	Accumulated Depletion and Depreciation	Net Book Value
Petroleum and natural gas rights	128,066	27,990	100,076
Production equipment and facilities	25,914	7,362	18,552
Office equipment	739	373	366
	154,719	35,725	118,994

At December 31, 2002, petroleum and natural gas rights include \$11,139,000 (2001 – \$9,437,000) relating to undeveloped properties which have been excluded from the depletion calculation.

4. BANK INDEBTEDNESS & LONG-TERM DEBT

The Corporation has a revolving demand credit facility which provides for a line of credit of \$50,000,000 bearing interest at prime (December 31, 2002 – 4.5%; 2001 – 4%) and has pledged an assignment of accounts receivable, a first floating charge on all of the Canadian assets and a fixed charge over certain property and equipment as collateral. As at December 31, 2002 bank indebtedness and long-term debt relating to Canadian operations was \$25,031,000 (2001 – \$22,900,000).

The Corporation also has a revolving demand credit facility in the United States for \$4,300,000 (US) bearing interest at US prime plus 3/4% (December 31, 2002 – 5%; 2001 – 5.5%) and has pledged a first floating charge on all of the US assets and a fixed charge over certain US property and equipment as collateral. As at December 31, 2002 bank indebtedness and long-term debt on US operations was \$248,000 (2001 – \$1,237,000).

Effective January 1, 2002, the Corporation adopted the recommendations of the Emerging Issues Committee of the Canadian Institute of Chartered Accountants concerning the presentation of revolving demand loans. These new recommendations require that the classification of debt in a debtor's balance sheet be based upon the facts existing at the balance sheet date rather than expectations. Prior to the adoption of the new recommendations, the Corporation presented the demand loan as long-term on the basis that the bank had indicated it was not its intention to call for repayment within one year provided there was no adverse change in the financial position of the Corporation. However, these loans are demand in nature and therefore are now presented as a current liability.

5. SHARE CAPITAL

The Corporation is authorized to issue an unlimited number of common shares with no par value and an unlimited number of first preferred and second preferred shares.

Common shares

(thousand)	2002		2001	
	Number of Shares	Amount \$	Number of Shares	Amount \$
Shares issued				
Balance, beginning of year	16,666	35,066	14,315	20,667
Shares issued for Hadrian	542	4,669	–	–
Issuance of common shares	–	–	2,000	13,547
Normal course issuer bid	–	–	(23)	(34)
Stock options exercised	429	1,262	374	886
Balance, end of year	17,637	40,997	16,666	35,066

On July 17, 2002 the Corporation issued 542,340 common shares as partial consideration for Hadrian Energy Corp. The shares issued were valued at \$8.75 per share. Costs of \$134,000 have been recorded net of tax of \$57,000.

On August 20, 2001 the Corporation issued 2,000,000 common shares for gross proceeds of \$14,100,000. Share issue costs of \$994,000 have been recorded net of tax of \$441,000.

A Normal Course Issuer Bid was filed with the Toronto Stock Exchange on November 22, 2000 whereby the Corporation was permitted to purchase and cancel up to 1,150,000 of its common shares prior to November 23, 2001. In 2001 23,000 shares were acquired at an average cost of \$4.57 per share of which \$34,000 was allocated to share capital and \$71,000 to retained earnings.

Stock Options

Stock options to acquire common shares are granted to employees and directors from time to time at exercise prices equal to the market value of the shares at the date of the grant. No compensation expense is recognized for grants under this Plan when stock options are issued. Any consideration paid on exercise of stock options is credited to share capital.

The Corporation has reserved 1,431,000 shares at December 31, 2002 (December 31, 2001 – 1,260,000) for issuance under the stock option plan.

A summary of the status of the Corporation's stock option plan as at December 31, 2002 and 2001, and changes during the years ending on those dates is presented below:

	2002		2001	
	Shares (thousand)	Weighted Average Exercise Price \$	Shares (thousand)	Weighted Average Exercise Price \$
Outstanding at beginning of year	1,199	3.36	1,290	2.71
Granted	466	7.69	298	4.94
Exercised	(429)	2.94	(374)	2.37
Cancelled	(21)	7.37	(15)	4.28
Outstanding at end of year	1,215	5.10	1,199	3.36
Options exercisable at yearend	750	3.49	916	2.85

The following table summarizes information about stock options outstanding at December 31, 2002:

Range of Exercise Prices \$	Options Outstanding			Options Exercisable	
	Number Outstanding at 12/31/02 (thousand)	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price \$	Number Exercisable at 12/31/02 (thousand)	Weighted Average Exercise Price \$
2.14 to 2.60	325	1.2 years	2.56	325	2.56
3.00 to 3.90	140	0.6 years	3.07	140	3.07
4.05 to 5.40	285	3.2 years	4.76	285	4.76
7.20 to 7.45	382	4.0 years	7.41	–	–
8.28 to 9.05	83	4.2 years	8.96	–	–
	1,215		5.10	750	3.49

Stock Based Compensation

In periods prior to January 1, 2002, the Corporation recognized no compensation expense when stock options were granted to employees. Pro forma information regarding net income is required and has been determined as if the Corporation had accounted for its employee stock options granted after December 31, 2001 under the fair value method. The fair value for these options was estimated at the date of grant using a Black-Scholes Option Pricing Model with the following assumptions for 2002:

Volatility factor of expected market price (%)	18.6
Weighted average risk-free interest rate (%)	5.16
Dividend yield (%)	0
Weighted average expected life of options (years)	4

For purposes of pro forma disclosures, the estimated fair value of options is amortized to expense over the options' vesting periods. The Corporation's net income would be reduced by \$654,000 for the year ended December 31, 2002. Basic and diluted earnings per share figures would have been reduced by \$0.04 and \$0.04 respectively for the year.

6. INCOME TAXES

Income taxes differ from the amounts which would be obtained by applying statutory income tax rates to income before income taxes as follows:

(\$ thousand)	2002	2001
Statutory income tax rate	42.61%	43.33%
Computed income taxes	7,501	9,229
Add (deduct) income tax effect of:		
Non-deductible crown charges, net of Alberta Royalty Tax Credit	2,884	3,756
Resource allowance	(3,467)	(4,394)
Rate adjustment	(162)	(440)
Large corporation and capital taxes	378	358
Other	(208)	(345)
	6,926	8,164

As at December 31, 2002, the Corporation has exploration and development costs, unamortized oil and gas property expenditures, un depreciated capital costs, unamortized share issue costs and non-capital loss carry forwards available for deduction against future taxable income in aggregate of approximately \$86,893,000 (December 31, 2001 – \$72,591,000).

Future income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The components of the Corporation's future income tax liability are as follows:

(\$ thousand)	2002	2001
Net book value of capital assets in excess of tax pools	26,798	21,140
Site restoration	(1,529)	(1,359)
Non-capital loss carryforwards	(4,062)	(1,136)
Share issue costs	(242)	(379)
Attributed royalty income	(43)	(43)
	20,922	18,223

7. WEIGHTED AVERAGE NUMBER OF COMMON SHARES

(thousand)	2002	2001
Weighted average number of common shares outstanding during the year	17,233	15,558
Diluted weighted average number of common shares outstanding during the year	17,795	16,114

Diluted earnings and cash flow from operations per share reflect the dilutive effect of the exercise of the vested stock options outstanding. Shares of 561,999 (2001 – 556,012) were added to the weighted average number of common shares outstanding during the year in the calculation of diluted per share amounts. Adjustments to the numerator amounts were not required.

8. FINANCIAL INSTRUMENTS

The Corporation is a party to certain off-balance sheet derivative financial instruments which have fixed the price of a portion of its oil and natural gas production. The Corporation enters into these contracts for hedging purposes only, in order to protect a portion of its future Canadian cash flow from the volatility of crude oil and natural gas commodity prices.

The Corporation enters into currency contracts for hedging purposes because the price received for its products varies in close relationship to the US dollar currency exchange rate.

The Corporation enters into interest rate swaps in order to fix the rate of a portion of its bank indebtedness.

The Corporation has outstanding contracts at December 31, 2002 and 2001 as follows:

	Volume	Fixed Price Range	Range of Terms
At December 31, 2002			
Oil swaps	219,000 bbl	\$23.00 – \$24.80 US/bbl	Jan. 1/03 – Dec. 31/03
Natural gas swaps	360,000 gj	\$3.82 – \$3.90/gj	Jan. 1/03 – Mar. 31/03
	428,000 gj	\$4.85/gj	Apr. 1/03 – Oct. 31/03
Natural gas collars	360,000 gj	\$3.85/gj Put \$8.05/gj Call	Jan. 1/03 – Mar. 31/03
	428,000 gj	\$4.00/gj Put \$6.10/gj Call	Apr. 1/03 – Oct. 31/03
Currency collar	\$1,000,000 Cdn.	\$1.56 Put \$1.62 Call	Jan. 1/03 – Dec. 31/03
At December 31, 2001			
Oil collar	109,500 bbl	\$23.00 US/bbl Put \$28.15 US/bbl Call	Jan. 1/02 – Dec. 31/02
Oil swap	73,000 bbl	\$25.85 US/bbl	Jan. 1/02 – Dec. 31/02
Natural gas swaps	856,000 gj	\$3.48 – \$4.11/gj	Apr. 1/02 – Oct. 31/02
	608,000 gj	\$3.65 – \$3.77/gj	Jan. 1/02 – Oct. 31/02
Natural gas collars	604,000 gj	\$5.00/gj Put \$7.05 – \$9.15/gj Call	Jan. 1/02 – Mar. 31/02
Interest rate swap	5.35% int.	\$5,000,000 Cdn.	Jan. 1/02 – Apr. 30/02

At December 31, 2002, the cost to settle the above swaps would have been \$2,867,000 and as at December 31, 2001, \$1,447,000 would have been received to settle the above swap transactions. These instruments have no book values recorded in the financial statements.

9. SEGMENTED INFORMATION

(\$ thousand)

	2002		
	Canada	United States	Combined
Oil and gas sales	58,360	7,178	65,538
Total assets	148,119	5,541	153,660
Net capital expenditures*	33,603	1,945	35,548

(\$ thousand)

	2001		
	Canada	United States	Combined
Oil and gas sales	60,999	2,796	63,795
Total assets	123,262	4,664	127,926
Net capital expenditures*	50,675	4,501	55,176

*Includes property from business acquisitions

ELEVEN YEAR

FINANCIAL

AND OPERATING

SUMMARY

	2002	2001	2000	1999
FINANCIAL (\$ thousand, except per share amounts)				
Production Revenue	65,538	63,795	53,306	24,048
Less expenses – cash items				
Royalty expenses	13,508	14,222	10,716	4,033
Production expenses	15,649	11,933	8,615	6,120
General and administrative expenses (net)	3,455	3,083	2,189	1,463
Hedging (gain) loss	(669)	573	2,733	1,095
Bank and other interest	1,100	957	1,269	592
Current and capital taxes	378	358	288	103
Net Corporate Cash Flow	32,117	32,669	27,496	10,642
Less expenses – non-cash items				
Depletion, depreciation and foreign exchange	13,622	10,683	6,801	4,750
Future income tax	6,548	7,806	8,713	1,046
Site restoration and reclamation	1,268	1,045	720	585
Net Corporate Earnings	10,679	13,135	11,262	4,261
Per Share, diluted				
Cash flow (\$/share)	1.81	2.03	1.86	0.70
Net earnings (\$/share)	0.60	0.82	0.76	0.29
Net Capital Expenditures	35,548	55,176	30,514	16,945
Balance Sheet at Year-End				
Property and equipment, net	141,006	118,994	74,394	50,383
Bank and other debt	25,279	24,137	15,902	14,116
Shareholders' equity	86,595	69,985	42,522	32,523
Shareholders' equity (\$/share)	4.91	4.20	2.97	2.26
Average Common Shares Outstanding (thousand)	17,233	15,558	14,408	14,686
Year-End Common Shares Outstanding (thousand)	17,637	16,666	14,315	14,420
OPERATIONS				
Total Production (boe/d)	6,349	5,553	4,140	3,236
Oil and liquids (bbl/d)	2,968	2,441	1,725	1,711
Natural gas (mmcf/d)	20.29	18.67	14.49	9.15
Boe/d per million shares	368	357	287	224
Total Proven Reserves (mboe)	21,870	20,605	16,200	12,387
Proven oil and liquids (mbbl)	11,114	10,482	6,340	5,210
Proven natural gas (bcf)	64.54	60.74	59.16	43.06
Boe per share (yearend)	1.24	1.24	1.13	0.86
Total Proven and Probable Reserves (mboe)	26,756	25,793	21,256	16,233
Proven and probable oil and liquids (mbbl)	13,776	13,413	8,676	7,090
Proven and probable natural gas (bcf)	77.88	74.28	75.39	54.85
Average Selling Prices (before hedges)				
WTI oil price (\$US/bbl)	26.08	25.90	30.20	19.24
FOB Edmonton oil price (\$/bbl)	39.94	39.18	44.33	27.35
Zargon field oil price (\$/bbl)	34.45	31.86	40.73	25.02
NYMEX Henry Hub Price (\$US/mmbtu)	3.35	3.94	4.31	2.27
Alberta AECO natural gas price (\$/mmbtu)	4.18	5.43	5.60	2.92
Zargon field natural gas price (\$/mcf)	3.81	5.19	5.20	2.52
Other Data				
Net wells drilled	31.6	47.7	38.6	18.8
Net undeveloped land (acres)	331.3	240.7	213.1	177.2
Closing share price (\$/share)	9.00	7.20	4.45	3.00

1998	1997	1996	1995	1994	1993	1992
14,264	16,800	12,150	8,244	5,748	4,016	2,130
1,837	2,652	2,075	1,293	997	751	529
5,080	5,081	3,324	2,875	2,095	1,474	658
1,252	1,035	741	508	416	277	205
(180)	44	434	-	-	-	-
377	142	232	313	122	196	134
77	181	236	-	-	(39)	59
5,821	7,665	5,108	3,255	2,118	1,357	545
3,659	3,276	2,028	1,733	1,179	830	382
430	1,421	910	507	20	40	5
482	490	267	215	194	128	21
1,250	2,478	1,903	800	723	359	137
0.43	0.62	0.51	0.37	0.28	0.25	0.16
0.10	0.20	0.19	0.10	0.09	0.08	0.05
12,477	13,371	7,821	5,526	4,730	6,017	1,972
38,189	29,371	20,776	14,983	11,604	8,146	3,021
6,178	4,872	491	2,864	2,040	400	1,393
29,320	22,364	18,060	11,127	9,048	7,696	1,575
1.98	1.80	1.54	1.20	1.12	1.02	0.61
13,025	12,051	9,659	8,441	7,595	5,781	4,050
14,810	12,553	10,486	9,261	8,061	7,510	4,050
2,563	2,445	1,629	1,347	993	771	362
1,508	1,385	1,012	885	616	426	256
6.33	6.36	3.70	2.77	2.26	2.07	0.63
196	203	169	159	131	133	89
9,736	7,811	5,903	4,213	3,499	2,743	1,000
5,072	4,134	3,706	2,744	2,099	1,371	720
27.99	22.06	13.18	8.82	8.40	8.23	1.68
0.66	0.62	0.50	0.46	0.43	0.34	0.25
12,942	10,088	8,483	6,595	5,886	4,743	1,506
6,984	5,700	4,728	3,986	3,576	2,643	1,006
35.75	26.33	22.53	15.66	13.86	13.27	3.00
14.42	20.61	22.01	18.40	17.17	18.48	20.55
20.08	27.64	29.23	24.04	21.86	21.90	23.52
17.80	24.70	26.91	21.79	19.41	18.53	20.25
2.09	2.48	2.72	1.69	1.92	2.12	-
2.07	1.80	1.47	1.19	1.96	1.93	1.36
1.93	1.86	1.62	1.19	1.67	1.49	0.93
4.9	14.6	8.5	6.5	6.9	0.1	-
115.8	81.4	63.5	44.5	23.6	18.1	9.5
2.40	3.40	2.32	1.80	1.07	1.10	-

CORPORATE INFORMATION

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President and Chief Executive Officer

Mark I. Lake
Vice President, Exploration

Daniel A. Roulston
Vice President, Operations

Sheila A. Wares
Vice President, Accounting

Kenneth W. Young
Vice President, Land

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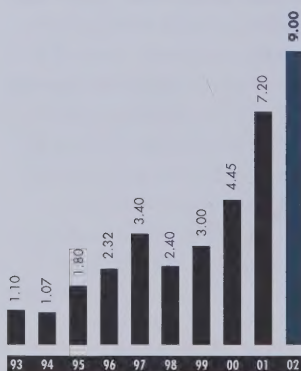
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Zargon Year End Share Price

ABBREVIATIONS

bbl	Barrel
bbl/d	Barrels of oil per day
bcf	Billion cubic feet
boe	Barrel of oil equivalent (6 mcf is equivalent to 1 bbl)
boe/d	Barrel of oil equivalent per day
btu	British thermal units
gi	Gigajoule
m	Thousand
mm	Million
mcf	Thousand cubic feet
mcf/d	Thousand cubic feet per day
PV	Present value
PVBT	Present value before tax

